Employer's Guide to **Fringe Benefit Rules**

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The 'Taxing' Matter of Long Term Incentive Programs

House lawmakers on June 30 approved the Restoring American Financial Stability Act of 2010, a major financial regulatory reform bill that would make significant reforms to executive compensation practices. At press time, the measure was before the Senate.

Compensation and incentive plans frequently go hand-in-hand with fringe benefits, but some professionals — including guest columnist Jim Moniz, an expert on management compensation — focus on other types of "fringe benefits," including long term incentives (LTIs). Moniz provides a definition of each of the components of this group of fringe benefits. ***Page 2***

Business Travel Begins to Show Signs of Life — and of Frugality

Employers have gotten creative in cutting business travel expenses in recent years. The *New York Times* reported June 21 that Energizer Battery Company, based in St. Louis, Mo., started offering employees monetary incentives to fly in coach instead of business class. Embassy Suites Hotels found in a survey that 17 percent of respondents have shared hotel rooms with colleagues on business trips in the past year.

The flagging economy may be a reason for some employers' novel approaches to reducing travel costs, but Energizer began its incentive program before the recession began. Air transportation and lodging are common working condition fringe benefits. Such new twists in these aspects of business travel deserve a closer look, especially in light of their tax implications. ***Page 6***

Bill Seeking to Reduce Misclassification Gets Attention in Congress

Employers that misclassify employees as independent contractors hurt workers and law-abiding businesses alike, said witnesses at a recent Senate hearing. Some witnesses urged passage of a bill to address the matter; however, one countered that the bill could end up harming true independent contractors and businesses that deal with them.

This occurs against the backdrop of the IRS conducting its biggest audit initiative in 25 years in the area of fringe benefits and employee misclassification to help close a massive tax gap. Washington Watch takes a look at how Congress is tackling the problem of employee misclassification. ***Page 10***

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The 'Taxing' Matter of Long Term Incentives

By James E. Moniz

James E. (Jim) Moniz is CEO of Northeast VisionLink, a company that specializes in executive compensation and works with businesses to structure compensation and rewards strategies. Moniz is a national speaker on the topic of wealth management and executive compensation. He holds a Master of Science in Financial Services, and Graduate Certificates for specialized study in pensions and executive compensation, estate planning and financial asset management. Moniz is a chartered financial consultant and chartered life underwriter.

On the same par with profitability and growth, a primary goal of most company owners is to create a business culture that fosters achievement by key employees. Long-term incentive (LTI) programs are important to recruiting, retaining and motivating vital employees whose skill and knowledge are fundamental to the overall success of the organization.

To an increasing extent, executive compensation includes an array of LTIs, including:

- performance unit plans;
- phantom stock;
- restricted stock;
- non-qualified stock options;
- incentive stock options; and
- deferred compensation plans

The definition of these "fringe benefits" varies significantly, as does their tax implications.

Performance Unit Plans

A performance unit plan is an award with a value tied to the increase in the financial metrics of a company as defined by a formula specific to a company, is typically vested over a period of three or four years.

While the employee, independent contractor or outside director has no tax liability at the time of grant, cashing out of the unit becomes a taxable event at which time the recipient is liable for ordinary income.

In terms of the company's tax ramifications, the Financial Accounting Standards Board (FASB) requires anticipated payments to be expensed as compensation during the performance period and no tax deduction is available until executives are paid.

Phantom Stock

Phantom stock is an LTI designed to provide employees, independent contractors or directors with cash payments equivalent to amounts they could receive under an actual stock option or similar program, but without the issuance of actual stock. Based on "phantom" or "simulated" shares, these units may be equivalent to a public company's fair market value of the stock, or a private organization's calculated value.

The executive does not have income tax liability at grant or vesting, but is taxed at ordinary income rates upon exercise/payout of the phantom stock unit.

The company's tax treatment of phantom stock is more complicated. A charge to earnings is made equal to the value plus appreciation, spread over the vesting period; in addition, the tax deduction must be equal to the amount of income recognized by the phantom stock holder.

Restricted stock is generically defined as forfeitable shares of employer stock which become non-forfeitable upon meeting certain terms and conditions. Under this LTI option, shares of the employer's stock are issued to an employee, independent contractor or director with the

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recipient paying nothing, a discounted purchase price, or full value for the shares.

Tax is not levied on the executive at issuance; however, the shares are subject to tax once vested. At that time, the holder realizes ordinary income equal to the difference between the stock's fair market value at vesting and, if applicable, the amount paid by the recipient to purchase the shares.

The company receives a tax deduction for the full value of shares upon vesting, but is required to charge earnings only for the fair market value of the shares at issuance.

Non-qualified Stock Options

Non-qualified stock options (NSOs) are granted by a company and allow an employee, independent contractor or director to purchase shares of the company's stock in the future at a predetermined purchase price. NSOs are an option that typically vests over time.

There is no tax at either grant or vesting for the receiving executive; however, an NSO is taxed upon exercise. At this time, the holder realizes ordinary income equal to the difference between the stock's fair market value at exercise and the exercise price. NSOs also are taxed upon sale of the stock; the holder realizes income at sale of the stock equal to the stock's appreciation after the exercise of the NSO and may be taxed at capital gains rates. Employees can pay taxes through withholding and year-end reconciliation on their tax return.

The combination of tax deductions, fixed charges to earnings and cash inflow, makes an NSO attractive to companies — the tax benefit of the deduction is credited directly to the capital account and the company receives cash inflow from the NSO's exercise price and from the cash value of the tax deduction.

Incentive Stock Options

Incentive stock options (ISOs) allow an employee to purchase shares of the company's stock in the future at a predetermined purchase price and on favorable terms for income tax purposes. Available only to employees and not to independent contractors, ISOs may be granted for a term not to exceed 10 years and an exercise price not less than 100 percent of the stock's fair market value at grant.

No tax at exercise and tax at sale at long-term capital gains rates makes an ISO an appealing option for employees; however, one drawback is the necessity to hold stock at least one year after exercise to satisfy holding period requirements.

For the company, a primary negative feature is the lack of a tax deduction and the limitation of grants to employees only.

The bottom line is: the more effective a long-term incentive plan is, the more focused the employees will be on the long term growth needs of the company and it will be more difficult for key employees to leave their post for other opportunities.

Deferred Compensation Plans

Deferred compensation plans (DCPs), which are limited to management and/or highly compensated employees (HCEs, see ¶105 and ¶270 of the *Guide*), are designed to provide a tax-deferred opportunity in excess of 401(k) limitations; supply supplemental retirement income for executives and allow for tax deferred capital accumulation potential. Monies otherwise payable to executives are withheld by the company until payment upon retirement or other specified future date; voluntary employee deferrals may be augmented by an additional company contribution or match.

Employee deferrals, company contributions and subsequent earnings are taxable to executives when distributed in the future, allowing for the pre-tax buildup of employee accounts.

See *LTIs*, p. 4

Qualified Employee Discounts

Tips for Making Discount Offers Available to Employees

If an employer is approached by local businesses — such as fitness centers, tire shops and phone service companies — that want to make special discount offers available to its employees, how should an employer handle it?

There are many ways an employer can respond. These include:

- Seeking scrupulously to avoid making any solicitations for, or endorsements of, specific businesses and even the appearance of doing so. Such employers, which include those that have employees that belong to unions or in which there is a union organizing campaign, do not make information about discount offers available at all.
- Putting brochures and flyers from the businesses in a break room. This makes information available, but does not actually make a good or a service available. This approach has no tax consequences and does not result in any taxes being imposed on the employees or the employer.
- Trying to strike a balance between providing offers from organizations that support the employer through a partnership or other business arrangement and those that do not, so as to provide employees with as many options as possible while also supporting businesses with which the employer may have a relationship.
- Entering into contracts with third-party administrators (TPAs) that make employee discounts available. Such TPAs recruit vendors that actually offer discounted goods and services, make those offers available to the employees and provide employee support so the employer and its human resources department do not have to be involved in making discounts available. TPAs that offer such services can charge employers for their services.
- Providing information on its intranet concerning discounts available to employees.
- Setting the parameters within which it will make discount offers known to employees (see box).

For more information on qualified employee discounts, see Tab 200 of the *Guide*.

Ground Rules an Employer Can Set For Discount Offers

Following are examples of guidelines an employer can set for the discount offers it will make available, or known, to employees.

1) An offer for employees should be uniquely for them and not typically be available to non-employees. Through this requirement, an employer can weed out businesses that just want the employer to send free ads to their employees.
2) The vendor is responsible for notifying the employer when the terms of the discount change or are no longer available.
3) No on-site meetings will be held for outside businesses that only want to sell something to employees. Such vendors can be limited only to electronic means of making their offers known to employees.

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Deferred compensation is subject to ordinary tax rates when paid out to the employee with the company receiving a tax deduction in the amount of the payment when made to the employee.

Companies considering any specific LTI plan should consult with appropriate experts for design, management, funding, comprehensive requirements and a review of the specific legal and tax consequences.

Motivation and Golden Handcuffs

The bottom line is: the more effective a long-term incentive plan is, the more focused the employees will be on the long term growth needs of the company and it will be more difficult for key employees to leave their post for other opportunities.

Washington Watch

Bill Seeking to Reduce Misclassification Gets Attention in Congress

Employers that misclassify employees as independent contractors hurt workers and law-abiding businesses alike, said witnesses at a recent Senate hearing, some of whom urged passage of a bill to address the matter. However, one witness countered that the bill could end up harming true independent contractors and businesses that deal with them.

When workers are incorrectly classified as independent contractors — as opposed to "employees" covered by the Fair Labor Standards Act — they are deprived of the law's minimum wage and overtime protections. The bill, S. 3254, introduced in April by Sen. Sherrod Brown (D-Ohio), provides that employers would have to give workers notice about whether they were being treated as employees and keep certain records on wages and hours. The bill also would establish penalties of up to $5,000 for violations.

"When … companies play games with workers' rights, everyone loses — workers, taxpayers and responsible businesses that play by the rules," Sen. Tom Harkin (D-Iowa) said in a prepared statement in support of the bill. According to Harkin, more than 10.3 million workers, or about 7.3 percent of the workforce, are treated as independent contractors — and as many as 30 percent of businesses may misclassify these workers.

U.S. Department of Labor Deputy Secretary Seth D. Harris expressed strong support for the bill and noted that worker misclassification is a DOL priority. For example, the agency is now considering a proposed regulation that would require employers, before deciding a worker is not a covered "employee," to perform a written analysis of the worker's status, according to Harris' prepared statement. He noted that passage of S. 3254 would help DOL in its enforcement efforts.

Another witness, however, had a different take on the bill. Gary Uber is co-founder of a licensed "nurse registry" in Florida that does business with about 800 registered caregivers who operate as independent contractors. In a prepared statement, Uber argued that the bill would "increase to an intolerable level the financial risks associated with doing business with independent contractors." That might end up reducing employment opportunities for legitimate contractors, he said.

Financial Reform Legislation Includes Executive Compensation Reforms

The most extensive rewrite of financial markets and banking laws in many years cleared one of its last hurdles June 30 when the House approved the Restoring American Financial Stability Act of 2010 (H.R. 4173). The bill is the product of marathon negotiating sessions that lasted into the wee hours June 25 as lawmakers hammered out the House and Senate versions in conference committee. At press time, the bill faced its last hurdle before it could be cleared for President Obama's desk, as Senators scrambled to gather the necessary votes for it to pass that chamber.

The 2,400-page bill contains some significant provisions that would affect executive compensation practices, including:

- requiring a shareholder vote on executive pay and golden parachutes;
- SEC power to grant shareholders proxy access to nominate board directors; a requirement the bill's authors say could help shift management's focus from short-term profits to long-term growth and stability;
- requiring independent compensation committees;
- SEC authority to write more rules on disclosing compensation with more clarity, including rules that would require companies to provide charts that compare their executive compensation with stock performance over a five-year period;
- heightened oversight over compensation in the financial industry, requiring federal financial regulators to issue and enforce joint compensation rules specifically applicable to financial institutions with a federal regulator; and
- requiring public companies to set policies to take back executive compensation if it was based on inaccurate financial statements that don't comply with accounting standards.

Travel and Entertainment Expenses

How Some Business Travelers Are Economizing

One Savings Tactic: Employer Pays Employees to Give up a Seat in Business Class

Some employees who travel for their jobs are discovering their more frugal sides, with a little encouragement from their employers. The *New York Times* reported in a June 21 article that Energizer Battery Company, based in St. Louis, Mo., offers employees monetary incentives to fly in coach instead of business class. In addition, Embassy Suites Hotels found in a survey that 17 percent of respondents had shared a hotel room with a colleague in the past year while traveling on business — a relatively uncommon practice that might give employers pause for a number of reasons (read on).

The flagging economy may be a reason for some employers' novel approaches to cutting travel costs, but Energizer began its program well before the recession began. Air transportation and lodging are common working condition fringe benefits (see Tab 400 of the *Guide*). Such new twists in these traditional benefits deserve a closer look, especially in light of their tax implications.

Incentives to Forgo Business Class

Doris Lee Middleton, human resources and travel services manager at Energizer, told the *Times* that if an employee who would otherwise be eligible to fly business class chooses coach instead, the company will split the savings in airfare up to $2,000 for all parts of the globe except Asia. For flights to the Asia-Pacific region, she said, the reward cap is $3,000.

Middleton confirmed to Thompson Publishing Group editors by phone that the company has reaped "substantial" savings on travel expenses from the incentive, which it calls the "rebate" program. She said that it is popular with employees, two-thirds of whom regularly travel on business. "During 2009," she said, "nearly 60 percent of Energizer's international trips were booked in economy class resulting in rebates to its colleagues and savings to the company."

One could safely assume — given that company travel policy generally allows for business class bookings on overseas flights — that virtually none of those seats would have been booked in economy class absent the rebate program, so Middleton's statistic reflects a rather high success rate. She added that the numbers are going up, too. The company put the rebate program in place several years ago, well before the recession hit.

Feedback, Middleton said, "has all been favorable from the colleagues. It's really been a huge win."

Tax Treatment

Travel and entertainment expenses, including air fare, generally are deductible by employers, subject to the limitations primarily contained in Code Section 274 (see ¶701).

The tax Code also bars favorable treatment for travel expenses that are "lavish or extravagant," although it directly refers here to meals and entertainment expenses, not transportation accommodations (see box for the text of Section 162; see also App. A).

Code Section 162 on "Lavish And Extravagant" Expenses

(a) In general. — There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including —

[T]raveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business …

Source: 26 U.S.C. §162(a)

Employers generally limit reimbursement for premium transportation accommodations through their corporate travel policies. A common limitation, like the one General Motors disclosed to the public amid the flap about perquisites and executive compensation when the company received a financial rescue from the federal government, is to allow employees to fly in business class only on international flights of 8 hours or longer and otherwise require that they fly in coach (see April 2009 newsletter).

Middleton said Energizer's policy is region-specific. For example, employees flying between regions (say, North America and Europe or North America and Latin America), are eligible to fly in business class at the company's expense.

While legitimate business travel expenses generally are excludable from the income of employees as working condition fringes, a cash reward for *not* flying in business class when an employee otherwise would be entitled to do so under company policy, is not. Nor is

See *Travelers*, p. 7

Travelers **(continued from p. 6)**

it deductible to the employer as a travel expense. Cash and cash-equivalent awards (think gift cards) are taxable income and should be reported as taxable earnings on an employee's W-2 form.

Frequent Flier Miles

Middleton said Energizer's rebate program does not preclude employees from using their frequent flier miles — including those accumulated on past trips for the company — to get upgrades from the airlines.

Thus, an employee could reap the benefits of the rebate program, collecting half the difference between a coach and business class ticket, and if they're fortunate, still wind up in business class. Of course, there is never a guarantee that an upgrade will be available. Even "confirmed" upgrades — those that are guaranteed upon purchase — come at a steeper price in terms of miles.

Employees who earn "free" flights or upgrades as a result of business travel paid for by their employers are not taxed on the benefits when they are used for business travel (see ¶710). The IRS will not tax employees on personal use of frequent flyer miles they earn on business trips.

Sharing a Hotel Room

Embassy Suites Hotels, a division of Hilton Worldwide, released a study June 9 that found that business travelers are taking to the road in greater numbers than they were earlier in the recession, but that they are finding diverse ways to be frugal.

The study found that, "Seven in ten (71 percent) respondents changed their business travel habits compared to 2009, with more business travelers flying coach, cutting back on meals and sharing rooms with colleagues due to the economic climate."

The survey also asked whether, as a result of the current economic climate, the respondents had ever shared a hotel room with a colleague while on business travel. The percentage of respondents who answered "yes" was 17. The survey did not ask whether sharing a room was mandatory.

The survey, which had 700 respondents, contained an "oversample" of 300 Americans ages 21 - 34 who had traveled on business at least once during the past year. Among them, 23 percent reported they had shared a room under such circumstances.

Other Ways of Saving

Of the entire sample, 43 percent said they have traveled less as a result of the economy (that dropped to 40 percent for the younger group). Among the larger sample, 27 percent reported they had cut back on meals and incidental expenses (30 percent of the younger subset made such a report). Twenty-nine percent overall said the economic climate had not changed the way they conducted business travel. Twenty-two percent of the younger subset made that statement, suggesting that younger employees are more willing to economize, either on their own volition or at the urging of their employer.

Although apparently few have to do without one, having a single-occupancy hotel room while traveling on business does not seem to be a hot issue, the study seems to suggest. When asked what aspect of business travel they most looked forward to, only 10 percent listed "having a hotel room to myself" as the answer. (The top answer was "seeing a new city, town or area," followed by "taking a break from the average day at the office" and "getting face time with clients, colleagues or superiors.")

'Reservations' About Sharing Hotel Rooms

There are no federal laws addressing whether an employer may require employees to share hotel rooms, but it still is possible that a single room could be a required reasonable accommodation for a disabled employee — for instance, if that employee needs special hygiene fixtures or furniture, etc., and can only obtain access to such support in a single room specially designed to meet his or her needs.

It also could be prudent for an employer to consider privacy, propriety, the possibility of harassment and avoiding a hostile work environment. An employer that requires employees to share hotel rooms on business trips should be flexible enough to ensure that the practice does not weaken the company's sexual harassment policy, which should be of primary concern.

Reimbursements

If an employer requires that employees who travel on business double up in hotel rooms, how does the employer handle reimbursement of lodging expenses? And are there tax consequences?

One employee could pay the lodging costs for a shared room up front, and the employer would reimburse only that employee. The CONUS rates the General Services Administration (GSA) sets and the high-low per diem rates the IRS sets, would apply as they would for any per diem lodging reimbursement. The rate for that location would apply and the employee would be subject to federal taxes on any reimbursement amount that exceeds the per diem. But neither rate policy addresses

See *Travelers*, p. 8

Travelers (continued from p. 7)

whether a room has one or more occupants, and there are no federal regulations mandating how many people must or can occupy a room — at least for purposes of reimbursements and per diems. (See ¶105 and ¶754 for more on the CONUS and high-low rates; see App. B for the CONUS rates.)

Under the federal travel regulations (FTR) governing federal employees' business travel, when a lodging receipt shows double occupancy and the other occupant was a federal employee on official travel, the double occupancy charge will be split between the two employees and the reimbursement limited to half the double occupancy rate. If the second occupant is not a federal employee on official travel, the actual reimbursement is limited to the single occupancy rate.

Private-sector employers can model their approach to double occupancy in a similar manner — that is, they can split the charge between two employees on business.

If an employer requires employees to share a room, it is likely that the employer would split the actual expenses between the employees — and therefore the actual reimbursements. But what does that mean for application of the CONUS or high-low rates for per diem reimbursement?

As with reimbursements an employer provides any employee, as long as those per diem reimbursements are at or below the CONUS rate for the location where the hotel was located, no tax will be imposed. If they exceed the CONUS rate, the amount by which they exceed the CONUS rate will be taxable.

Of course, using the per diem rates means that a specified amount is deemed substantiated, *Guide* Contributing Editor Jerry E. Holmes reminds us. "If the employer uses the per diem rates, then no receipt is necessary to substantiate the amount of the lodging expense," he said. He also suggests doubling up and applying the per diem rates could benefit employees financially: "If an employer pays a per diem rate, I would assume he doesn't care if the employees double up and make a few bucks."

An employer can choose not to use the federal per diem rates, however, and instead require an employee to substantiate the amount of the expense. What happens in this case? According to Holmes, the answer is quite simple. "If an employer chooses to use actual substantiation, then the employees would split the expense of sharing a room," he said.

Splitting the Savings

What if an employer offered an incentive similar to the one Energizer offers, and splits the difference between the cost of two single-occupancy rooms and the cost of one double-occupancy room? (By the way, Middleton said that Energizer's savings incentives do not include one that encourages employees to share hotel rooms on business trips.)

Whether the employer customarily reimburses employees for actual (substantiated) costs or based on the federal per diem rate, the consequence of an incentive payment is the same: it would be taxable. As long as any payment to an employee by an employer is not either the result of a valid substantiated business travel expense (or other expense that meets the criteria of a working condition fringe benefit), or based on a flat per diem schedule that meets the criteria of an "accountable plan," the payment must be included in taxable income (see ¶741).

For standard employee expense allowance programs that advance or reimburse employees' employment-related business expenses, the reportability of plan payments depends on plan design and the promptness with which employees submit substantiation and return any unspent allowances. Generally, the IRS requires that employees either substantiate reimbursed expenses or return unspent advances within a "reasonable period of time." Unfortunately, the IRS provides no definition of that term, but there are safe harbors (see ¶740).

Reporting and Recordkeeping

A Primer on the Form 5500 E-Filing Requirement

The U.S. Department of Labor's (DOL) Employee Benefits Security Administration (EBSA) has provided a fact sheet that provides comprehensive information concerning the Form 5500 and the new electronic filing system, EFAST2. Electronic filing became mandatory with the filings for the 2009 benefit plan year (filings that are made this year).

The Form 5500 is one of the most important means of providing information to the federal government concerning employee benefits. Given the importance of that data, the DOL, the IRS and the Pension Benefit Guaranty Corporation (PBGC) considered it a high priority to establish an annual reporting process that provides accurate and timely information regarding the Form 5500 in the most cost-effective manner possible. The EFAST2 system, expected to receive over 1 million filings each year, allows plan filers to upload Form 5500 information and data. The federal government argues that the new system is more cost-effective and generally provides access to filed reports within a day after the government receives it.

Background

The Form 5500 Series annual reports are the primary source of employee benefit plan financial information and data to the DOL, IRS and PBGC, as well as participants, beneficiaries, other federal agencies, researchers and the public.

In 2005, the DOL announced its intent to establish an electronic filing requirement for the Form 5500 Series, nearly five years before filers eventually needed to comply. As part of a public notice and comment process, the DOL twice deferred implementation of the requirement to allow plans and service providers more time to make the necessary adjustments.

In 2005, the DOL first issued a proposed rule to announce its intention to move to a wholly electronic filing system for receipt of Form 5500 Series filings beginning with filings for the 2007 plan year.

In 2006, the DOL published the final electronic filing rule, which deferred the electronic filing mandate to filings for the 2008 plan year.

In November 2007, the DOL published final rules on the proposed Form 5500 Series revisions deferring the electronic filing mandate by another year. The electronic filing requirement was deferred to apply to Form 5500 and small plan Form 5500-SF filings with EFAST2 made on or after Jan. 1, 2010.

Why Electronic Filing?

The DOL concluded that maintaining any paper filing system, even on a reduced scale and/or for a limited period of time, would be unduly costly and inefficient. It estimated that creating a system that could continue to process both electronic and paper submissions would cost more than twice as much to develop and operate than an all-electronic system.

The DOL concluded that any economic benefit that might accrue to some limited class of filers from a continued paper filing option would be outweighed by the benefits to participants and beneficiaries at large, and to the DOL and taxpayers generally, of implementing a single, wholly electronic system.

The DOL believes that an all-electronic filing system benefits plans, participants, sponsors and the public by:

- reducing filer error, which in turn can reduce the need for the government to correspond with filers and their burden in responding to correspondence and resubmitting the Form 5500 Series filings;
- increasing accuracy of filings, which can reduce the potential for filer penalties;
- increasing the timeliness of the data for public disclosure and enforcement, thereby enhancing the protections for participants and beneficiaries;
- reducing processing costs;
- improving the ability of EBSA to exercise its roles in enforcement, oversight, and disclosure; and
- enhancing the security of plan benefits.

Helping Filers Prepare

The DOL began an ongoing public outreach effort in 2009 to provide Form 5500 Series filers with the information they need to satisfy their electronic filing and annual reporting obligations.

The DOL established a website, http://www.efast.dol.gov, dedicated to the new EFAST2 system that includes an array of educational and compliance assistance materials, including FAQs and an IFILE tutorial.

The DOL staff conducted four webcasts designed to facilitate compliance with the new annual reporting requirements and electronic filing system, three of which are archived on the EBSA website. It has also

See *Form 5500*, p. 10

Form 5500 (continued from p. 9)

participated in a variety of educational conferences and outreach programs associations and other organizations have sponsored.

EFAST2 System Includes an IFILE Option

IFILE is an application available on the DOL website, at http://www.efast.dol.gov. It is free to use and allows filers to prepare, sign and submit individual Form 5500 and Form 5500-SF filings. IFILE includes a file sharing feature, which allows different people to work on a single filing in a coordinated and streamlined manner.

All parties required to sign the Form 5500 Series filings can obtain a personal identification number (PIN) through a simple registration process on the EFAST2 Web site. That PIN can be used as an electronic signature when filing the Form 5500 or the Form 5500-SF. The EFAST2 system greatly simplified the process for getting an electronic signature PIN so that anyone that can use the Internet and an email system can easily get a PIN.

The electronic signature process has two simple steps: (1) registering as a signer to get signer credentials and (2) affixing a PIN to the electronic form.

Electronic Signature Options

The DOL has issued guidance regarding the EFAST2 electronic filing requirements telling plan administrators that they must register for a PIN and then electronically sign the plan's Form 5500 or Form 5500-SF, as applicable, before it is filed with EFAST2 by personally affixing the PIN to the electronic submission. The PIN signature attests that the signer has reviewed the Form 5500 Series filing and that the information is true, correct and complete to the best of the signer's knowledge.

The guidance also provides that, because the EFAST2 PIN is the plan administrator's electronic signature for purposes of the Form 5500/Form 5500-SF, the PIN must be protected and not shared. The electronic filing regulations and the Form 5500/Form 5500 SF instructions also require that plan administrators keep a manually signed copy of the Form 5500 or Form 5500-SF as part of the plan's records.

Allowing a service provider to affix the plan administrator's PIN would be inconsistent with the DOL's current guidance because the administrator would not be personally electronically signing the filing, and the administrator would be sharing his or her PIN with the person preparing and transmitting the Form 5500 or Form 5500-SF to EFAST2.

The DOL has, however, responded to requests from the regulated community asking for a change in these electronic signature requirements by permitting plan administrators to authorize plan service providers that manage the plan's annual filing process to electronically submit the Form 5500/Form 5500-SF for the plan.

Under this new e-signature option, service providers that manage the filing process for plans can get their own EFAST2 signing credentials and submit the electronic Form 5500 or 5500-SF for the plan. Service providers and plan administrators must do the following:

- The service provider must confirm that it has specific written authorization from the plan administrator to submit the plan's electronic filing.
- The plan administrator must manually sign a paper copy of the electronically completed Form 5500 or 5500-SF and the service provider must include a PDF copy of the first two pages of the manually signed Form 5500 or 5500-SF as an attachment to the electronic Form 5500 or 5500-SF submitted to EFAST2.
- The service provider must communicate to the plan administrator (1) any inquiries received from EFAST2, DOL, IRS or PBGC regarding the filing, and (2) inform the plan administrator that, by electing to use this option, the image of the plan administrator's manual signature will be included with the rest of the return/report posted by the DOL on the Internet for public disclosure.

Civil Penalties for Failure to File the Form 5500 or Form 5500-SF

ERISA and the federal tax code provide for assessment or imposition of civil penalties when plans fail or refuse to file a complete and accurate annual return/report.

Electronic filing of the Form 5500 or Form 5500-SF is required and there are civil penalties for failing to file.

EBSA's efforts in 2010 are focused on helping employee benefit plan sponsors, especially small businesses, successfully make the transition to the new, electronic EFAST2 filing system. Nonetheless, the DOL will continue to seek civil penalties for violations of the annual reporting requirements in appropriate cases.

Contact Information

Those with questions about filing under EFAST2 or with general Form 5500 Series inquiries can call 1 (866) GO-EFAST (1 (866) 463-3278), weekdays 8:00 a.m. to 8:00 p.m. (Eastern time).

Working Condition Fringe Benefits

Police Officers' Donning and Doffing Victories Overturned

In the wake of a 9th U.S. Circuit Court of Appeals' opinion, the U.S. District Court for the Central District of California recently overturned three of its own rulings that had held the City of Los Angeles liable for back wages for time spent by its police officers donning and doffing their uniforms before and after their shifts. The three cases combined include about 2,500 plaintiffs, said one of the defendant's attorneys.

Earlier this year, the 9th Circuit ruled in *Bamonte v. City of Mesa*, 598 F.3d 1217 (9th Cir. 2010), that, unless the donning and doffing of uniforms and related gear done before and/or after a shift is required to be done on the employer's premises, these activities are not integral to the officers' principal activities and therefore noncompensable under the act (see *Steiner v. Mitchell,* 350 U.S. 247 (1956)).

The district court granted the city's motion for reconsideration of its earlier rulings in the three consolidated cases, *Nolan v. City of Los Angeles, Alaniz v. City of Los Angeles* and *Mata v. City of Los Angeles*. It wrote, "Following the Circuit's holding in *Bamonte* and the clear factual similarities of that case and the present matter, the Court concludes that 'donning and doffing of police uniforms and gear are noncompensable under the contextually-specific facts of this case' (598 F.3d at 1231)."

The district court also recently overturned its ruling in *Reed v. County of Orange,* No. SACV 05-01103-CJC, 2010 WL 2342394 (C.D. Cal., June 10, 2010) to comply with the *Bamonte* ruling. (*Nolan v. City of Los Angeles*, No. 04-02190 GAF (C.D. Cal. July 1, 2010); *Alaniz v. City of Los Angeles*, CV 04-08592 GAF (C.D. Cal. July 1, 2010); and *Mata v. City of Los Angeles,* CV 07-06782 GAF (C.D. Cal. July 1, 2010)).

The time it takes employees to put on and take off clothing an employer and/or the government requires that they wear while performing their jobs can be compensable (see ¶464 of the *Guide*).

Agency Briefs

GSA Publishes Guidance on Premium Travel

Federal agencies must now report all business-class travel and any other air transportation accommodation other than coach, as part of a "crackdown" on the use of first and business-class air tickets by federal employees. The General Services Administration (GSA), the arm of the federal government that sets travel and other policy, published guidance for federal agencies on how to comply with a set of Oct. 2009 final regulations that it had issued. The GSA had issued those regulations in response abuses the Government Accountability Office (GAO) uncovered in an earlier investigation.

Currently, agencies have to report to the GSA only first-class travel accommodations that were paid for by the government. (They do not have to report premium travel paid for by the traveler or obtained through frequent flier benefits or free upgrades.) Starting with fiscal 2011, agencies must also report any business-class accommodations or "any class of accommodations above coach-class, that is, first-class or business-class." (See Federal Travel Regulation Bulletin 10-05.) Some private-sector employers follow federal travel regulations, or model their policies using federal guidelines. The GAO report (07-1268) was published in Sept. 2007.

Private Letter Ruling Addresses Housing Expenses at Church-affiliated Orphanage

In a private letter ruling (PLR), the IRS has said that a church-affiliated organization that provides a foster care residential program for children under the age of 18, can exclude housing allowances it pays clergy members.

The IRS found that the orphanage was an "integral agency of the church." Thus, the housing allowances paid to "managers, executives, supervisors or administrators who are ordained, licensed or commissioned ministers" employed by the orphanage are excludable from income under Section 107 of the tax Code. The party that raised the issue, the IRS noted, received 95 percent of the funding for its operating expenses from the church, which also controlled the orphanage's entire board of directors.

The ruling is PLR 201023008 (June 11, 2010). PLRs do not carry the force of law nor do they constitute official IRS guidance. However, employers should be aware of the views the IRS expresses in PLRs because they suggest how the IRS interprets the law with regard to a specific fact pattern.

Subject Index Vol. 17

This index covers the *Employer's Guide to Fringe Benefit Rules* newsletter for Vol. 17, No. 2. It is arranged by subject. The numbers following each entry refer to the volume, issue and page numbers of the newsletter in which information on that topic appears. For example, the designation "17:2/3" indicates Vol. 17, No. 2, page 3. Court cases relating to a topic appear under that topic's entry.