

**USE IT OR LOSE IT...
OR NOT?**

On May 18, 2005, the Treasury Department and the IRS issued Notice 2005-42, effective this year, which allows employers to modify the deadline for Flexible Spending Arrangements (FSAs) reimbursement up to two and a half months after the end of the plan year. This means that employees whose cutoff for incurring FSA reimbursable expenses is December 31 could have until March 15 of the following year to use their excess FSA dollars. However, it is important to note that the change does not compel employers to extend the deadline, it only allows for them to elect to do so.

With FSA accounts, workers decide at the beginning of the year how much money they would like to set aside for health and dependent care expenses. This money is untaxed, and as workers incur expenses throughout the year, they are reimbursed out of this account by their employers. If workers underestimate

their expenses at the beginning, they lose potential tax savings. However, if they overestimate and do not spend the money, any unused portion at the end of the plan year is then forfeited to the employer.

The widely-used December 31 deadline for FSA reimbursement meant that there often was a rush to purchase non-essential health-related



Employees may now have longer to use their healthcare dollars

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items towards the end of the year to avoid simply losing the money altogether. Treasury Department Secretary John W. Snow stated, “The new rule will give workers with FSAs more time to pay for medical and dental expenses, and will ease the year-end spending rush prompted by the prior rule.”

In order to adopt the two and a half month grace period for the current year, companies must amend the plan documents before the end of the current plan year.▣

LESSON NUMBER ONE - COOPERATE WITH INVESTIGATORS

On May 24, 2005, the Public Company Accounting Oversight Board's (PCAOB) Division of Enforcement brought its first disciplinary action in which one accounting firm's registration was revoked and three former partners, including the managing partner, were disciplined. This action stems from the respondents' conduct in concealing information and submitting false information to the PCAOB.

According to the PCAOB, the

“THE FINDINGS IN THIS CASE DEMONSTRATE THAT THE BOARD WILL NOT TOLERATE CONDUCT AIMED AT THWARTING THE BOARD'S INSPECTIONS.”

– CLADIUS MODESTI, DIRECTOR OF THE PCAOB'S DIVISION OF ENFORCEMENT

managing partner and two other partners were aware that the firm had prepared the financial statements of two of its public company audit clients, contrary to auditor independence requirements.

The PCAOB found that, in response to a PCAOB request for information, the partners attempted to conceal the violation and purposely omitted certain requested information from the firm's written response. Further, the PCAOB found that the partners formulated and conducted a plan to create and back-date certain relevant documents and place them in the firm's audit files.

While two partners notified the PCAOB about the omitted and falsified information and resigned from the firm, the managing partner did not. Due to the two partners' extensive cooperation, including promptly and

voluntarily bringing the matter to the PCAOB's attention, they were only censured and were not required to admit or deny the findings.

In contrast, the managing partner, who did not cooperate with investigators, has been barred from association with a registered accounting firm.

In addition to actions against the individual respondents, the PCAOB has revoked the registration of the firm, which prohibits the firm from auditing the financial statements of public companies.

The contrast between the sanctions for the partners who did cooperate with the PCAOB investigation and sanctions for the one who did not highlight once again the importance of full cooperation with any investigation.▣

CLARIFICATION ON A COMPANY PERK

On May 27, 2005, the Treasury Department and the Internal Revenue Service (IRS) issued guidance regarding the application of the American Jobs Creation Act of 2004 (AJCA) to the tax treatment of the personal use of corporate aircraft for entertainment. This guidance relates to Section 907 of the AJCA, which limits the costs that a company may deduct when an executive uses a corporate aircraft for entertainment travel.

Prior to AJCA, a company could deduct the actual cost of providing flights to an executive on the corporate aircraft for entertainment purposes. While an executive would calculate the value of the flight using the Department of Transportation's Standard Industry Fare Levels (SIFL) formula and report the value as additional income, a company would deduct the actual cost of providing the flight, including all fixed and operating

costs, which is far greater than the SIFL calculated amount. Section 907 of the AJCA addressed the difference.

Under the AJCA, which was intended to overturn Tax Court precedent, a company is limited in the amount that it may deduct to the amount that is treated as compensation to the executive. Thus,



New guidance was issued on the personal use of corporate aircraft

a company may only deduct the expense to the extent the company treats as compensation to the executive an amount equal to or greater than the amount of the deductible entertainment expenses allocable to entertainment provided to the executive. Expenses allocable to entertainment provided to an executive that are not treated as compensation to the executive are disallowed. While the IRS guidance released on May 27 relates to aircraft expenses, the IRS stated that the guidance applies to expenses paid or incurred in connection with other entertainment activities.

Companies should conform their policies with respect to the use of corporate aircraft to the AJCA and the IRS guidance while keeping in mind the Securities and Exchange Commission's recent focus on fringe benefits. ■

CHANGE OF CONTROL PROVISION DOES NOT CREATE SPECIAL VOTING RIGHTS

A recent Delaware case held that a provision in a golden parachute agreement did not contravene Delaware law because the provision neither limited nor expanded the voting power of any director. Section 141(d) of the Delaware General Corporation Law provides that if one category or group of directors is given distinctive voting rights not shared by the other directors, those distinctive voting rights must be set forth in the certificate of incorporation.

Lone Star Steakhouse & Saloon, Inc. entered into agreements with certain members of management to make golden parachute payments upon a change of control. A change of control included, among other things, a change in the composition of the board of directors, which would be deemed to occur when the "Existing Directors" constituted less than a majority of the board at any time during the two year period following the effective date of the agreements. "Existing Directors" included members of Lone Star's board on the effective date of the

agreements, as well as any new directors approved by the then-Existing Directors.

A significant institutional stockholder sought to invalidate those agreements by arguing that the "Existing Director" provision violated Section 141(d) and, thus, was adopted in violation of the directors fiduciary duties.

The Delaware court disagreed, holding that the Existing Director provision simply provided an after-the-vote measure for ascertaining whether there had been a triggering event for the purposes of finding a change in control. There was nothing in the Existing Director provision that required a director vote, and the provision neither limited nor expanded the voting powers of any director.

This now-sanctioned provision in a golden parachute agreement will allow for normal turnover of directors without inadvertently triggering change in control payments. ■

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