



STATE OF MINNESOTA

OFFICE OF THE ATTORNEY GENERAL

LORI SWANSON
ATTORNEY GENERAL

April 20, 2010

SUITE 900
445 MINNESOTA STREET
ST. PAUL, MN 55101-2127
TELEPHONE: (651) 297-1075

Via Electronic Mail


Hon. Bruce H. Johnson
Assistant Chief Administrative Law Judge
Minn. Office of Administrative Hearings
P.O. Box 64620
St. Paul, MN 55164-0620

**Re: In the Matter of the PERA Salary Determinations Affecting Retired and Active Employees of the City of Duluth
OAH Dkt. No. 4-3600-20809-2**

Dear Judge Johnson:

Enclosed in the above-referenced matter please find the Supplemental Memorandum of Law in Support of PERA's Motion for Summary Disposition (including referenced materials) and a Certificate of Service. By copy of this letter, the parties listed below are hereby being served. The electronically transmitted documents will follow by U.S. Mail.

Very truly yours,



JON K. MURPHY
Assistant Attorney General
(651) 757-1385 (Voice)
(651) 297-4139 (Fax)

Enclosures

cc: Elizabeth A. Storaasli, Attorney at Law (w/ enc.)/via Electronic Mail
Bryan F. Brown, Attorney at Law (w/ enc.)/via Electronic Mail
Lisa Wilson, City Attorney (w/ enc.)
Mary Vanek, Executive Director, PERA (w/ enc.)
Cheryl Keating, PERA (w/ enc.)

AG: #2623156-v1



STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE PUBLIC EMPLOYEES RETIREMENT ASSOCIATION
600 North Robert Street
St. Paul, MN 55101

In the Matter of the PERA Salary
Determinations Affecting Retired and Active
Employees of the City of Duluth

**CERTIFICATE
OF SERVICE**

OAH Docket No. 4-3600-2080902

I, JOY FRIEDMAN, declare under penalty of perjury that on April 20, 2010, I mailed a copy of the **Supplemental Memorandum of Law in Support of PERA's Motion for Summary Disposition (along with the attached referenced materials)** to be served by electronic mail and U. S. Mail as set out below, at the City of St. Paul, Minnesota, a true and correct copy thereof, properly enveloped with prepaid postage thereon, and addressed as follows:

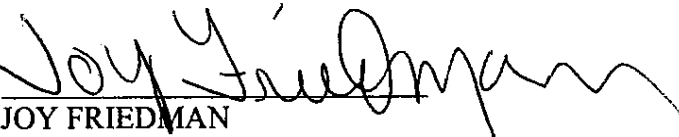
Elizabeth A. Storaasli
Attorney at Law
Suite 200
202 W. Superior Street
Duluth, MN 55802-1960

Via Electronic Mail:
eastoraasli@lawduluth.com

Bryan F. Brown
Attorney at Law
129 East Arrowhead Road
Duluth, MN 55803

Via Electronic Mail:
bryanfbrown@aol.com

Executed on: April 20, 2010

Signed: 
JOY FRIEDMAN
Office of the Attorney General
445 Minnesota Street, Suite 900
St. Paul, MN 55101-2127
651-757-1236

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

In the Matter of the PERA Salary
Determinations Affecting Retired and Active
Employees of the City of Duluth,

Allen Johnson, et al., Petitioners.

**SUPPLEMENTAL MEMORANDUM OF
LAW
IN SUPPORT OF
PERA'S MOTION FOR SUMMARY
DISPOSITION**

OAH Docket No. 4-3600-2080902

PERA's salary definition in Minn. Stat. § 353.01, subd. 10 (2008) does not specifically define the terms "compensation," "employer paid fringe benefits," "flexible spending accounts" or "cafeteria plans. Just because these terms are not specifically defined does not mean they can be ignored: "Whenever possible, no word, phrase, or sentence of a statute should be deemed superfluous, void, or insignificant. *ILHC of Eagan, LLC, d/b/a/ the Commons on Marice v. City of Dakota*, 693 N.W.2d 412, 419 (Minn. 2005), citing *Owens v. Federated Mut. Implement & Hardware Ins.*, 328 N.W.2d 162, 164 (Minn. 1983).

In *United Saving Association of Texas v. Timbers of Inward Forest Associates, Ltd.*, 484 U.S. 365, 371, 108 S. Ct. 626, 630 (1988), the Supreme Court recognized that "statutory construction" is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme--because the same terminology is used elsewhere in a context that makes its meaning clear. Although courts should not construe different terms within the same statute to embody the same meaning, that does not mean there cannot be overlap between words in a statute, such that, in some cases, both apply. *United States*

v. Hill, 79 F.3d 1477 (6th Cir. 1996).¹ In all cases involving statutory construction, the starting point must be the language employed by the legislature and the Court may assume that the legislative purpose is expressed by the ordinary meaning of the word used. *American Tobacco Co. v. Patterson*, 456 U.S. 63 69, 102 S. Ct. 1534, 1537 (1982). Under the most basic canons of construction, statutory words and phrases are construed according to rules of grammar and according to their most natural and obvious usage unless it would be inconsistent with the manifest intent of the legislature. *ILHC of Eagan, LLC, d/b/a/ the Commons on Marice v. Cty of Dakota*, 693 N.W.2d 412, 419 (Minn. 2005); Minn. Stat. § 645.08(1) (2009); *FDIC v. Meyer*, 510 U.S. 471 (1994) (In the absence of a definition, courts construe a statutory term in accordance with its ordinary or natural meaning.).

The terms voluntary salary reduction agreement, fringe benefits, deferred compensation, and flexible benefit accounts have ordinary and acceptable meanings in the employment benefit world and those meanings closely track IRS laws' definitions in order to take advantage of IRS' exclusions from taxable income. This Supplemental Memorandum is intended to provide further definition to those terms.

I. EMPLOYER-PAID CONTRIBUTIONS TO QUALIFIED DEFERRED COMPENSATION ACCOUNTS ARE NOT "COMPENSATION" FOR PERA PURPOSES, NOR DO THEY FIT THE CLASS OF VOLUNTARY SALARY REDUCTIONS SPECIFICALLY INTENDED TO BE INCLUDED AS SALARY.

"Compensation" is not defined in section 253.01, subd. 10(a)(1). However, it is followed by the phrase, "or other voluntary salary reduction programs." The IRS defines the term,

¹ MSRS' 1995 amendment excluding employer contributions to deferred compensation from salary does not mean that the MSRS' other exclusions from salary, i.e., employer-paid fringe benefits, could not also apply. By Board policy, MSRS had for a number of years included employer contributions as salary. After many years of including these contributions as salary, it was reasonable for MSRS to provide a specific exclusion. Because MSRS did not interpret its law as excluding employer paid, it amended its statute to make it more explicit. In contrast, for many years PERA excluded employer contributions and found no need to further amend its law.

“voluntary salary reduction agreement” as, “a way to provide pre-tax benefits to employees without additional cost to the employer under which an employee can choose between receiving a fixed amount of taxable cash or a qualified fringe benefit.” See Taxable Fringe Benefit Guide, Federal, State, And Local Governments, the Internal Revenue Service, January 2010, selective pages attached. PERA’s salary definition was intended to ensure that moneys that would otherwise be payable as wages or salary, but are paid under a salary reduction agreement, are included and not excluded from the definition of salary simply because of their tax deferred status. The plain language of the salary definition assures that “voluntary salary reduction programs” are included in the definition of salary. The rule of “ejusdem generis” requires a finding that the legislature had in mind things of the same kind; “voluntary salary reduction programs,” and therefore, any deferred compensation must fit that class in order to be considered “salary.” See *Foley v. Walen*, 219 Minn. 209, 216, 17 N.W.2d 367, 371 (1945). The City of Duluth’s employer paid contributions to qualified deferred compensation accounts do not fit that class since they are not voluntary salary reductions. They are in addition to Petitioners’ bargained for wages, not a reduction from those wages.

Employee compensation plans are closely structured to take advantage of those types of benefits excluded from taxable income under federal tax law. Here, Petitioners and the City of Duluth bargained for employer contributions to “a qualifying and approved deferred compensation plan and/or for contribution to family-dependent hospital medical premium,” (2007 CBA, Article 17). In addition, under Section 18, entitled-HOSPITAL-MEDICAL INSURANCE, they bargained for contributions to either a qualified deferred compensation plan or to a flexible spending account (2007 CBA, art. 18.). It should be assumed that the bargaining parties had in mind or knew what these terms meant and what they were bargaining for.

A qualified deferred compensation plan is a plan qualified under 26 U.S.C. section 457. It is instructive to look to that law to determine whether employer paid contributions are considered to be compensation. The definition afforded “compensation” for tax-qualified 457 plans distinguishes between “elective deferrals,” i.e., deferred compensation amounts, the amount of which is determined by an employee under a written agreement, and “non elective deferrals,” i.e., employer-paid amounts where the employee has limited choice. The term compensation for §457 purposes does not include contributions made by the employer to the plan, to the extent those amounts are not included in the employee’s income for the year in which contributed. *See* 26 U.S.C. §§ 457(e)(4) (c)(3) and 26 U.S.C. part 1.415(c)-2(c). In addition, § 353.01, subd. 10(5) excludes from PERA salary, any compensation that exceeds the limitations of Minn. Stat. § 356.611(2008). Tracking federal law’s limitations on maximum benefit and contribution limits, Minn. Stat. § 356.611, subd. 4, defines compensation as a member’s compensation “actually paid or made available for any limitation year including items described in federal treasury regulation section 1.415 (c)-2(b) and excluding items described in federal treasury regulation section 1.415 (c)-2(c). It includes elective deferrals, but not employer paid deferrals. *Id.* It would make no sense to construe the term “compensation” inconsistent with how that term is defined in the law that governs the plans the contributions are being made to.

Petitioners’ arguments for employer paid contributions being included in the definition of salary could apply equally to the City of Duluth’s contributions to PERA. Minn. Stat. § 353.27 provides for employee and employer contributions based upon a percentage of salary. Employee contributions are deducted from salary as defined in section 353.01, subd. 10. Employer contributions are paid from a governmental subdivision’s tax or revenue funds. *See* Minn. Stat. §§ 353.27 and 353.28 (2009). Employer contributions to PERA are a benefit which could also

fall under the general concept of “compensation.” If PERA was not a tax-qualified governmental plan, the contributions and/or the accrued pension benefit would be considered to be taxable income. No one has ever claimed that the employer contributions should be compensation that increases an employee’s salary. The only difference between the City of Duluth’s contributions to qualified deferred compensation plans and its employer contributions to PERA is that one is bargained for and the other is required by statute.

II. EMPLOYER CONTRIBUTIONS TO DEFERRED COMPENSATION ACCOUNTS ARE FRINGE BENEFITS.

Since 1994, PERA’s salary definition has excluded:

(2) employer-paid amounts used by an employee toward the cost of insurance coverage, employer-paid fringe benefits, flexible spending accounts, cafeteria plans, health care expense accounts, day care expenses, or any payments in lieu of any employer-paid group insurance coverage,

Minn. Stat. § 353.01, subd. 10 (b)(2) (2008). The phrase, “employer-paid fringe benefits,” was added in 1994. Laws 1994, ch. 528, art. 2, §§ 1 to 4. While the phrase is not defined, numerous authorities support a finding that employer-paid contributions to deferred compensation accounts are “fringe benefits.”

First, Minnesota law recognizes that pension contributions are a fringe benefit. Petitioners and the City of Duluth collective bargaining is governed by the Public Employees Labor Relations Act, Minn. Stat. ch. 179A (“PELRA”). Section 179A.03, subd. 19 of that Act sets forth the boundaries for permissible bargaining:

“Terms and Conditions of Employment.” “Terms and conditions of employment” means the hours of employment, the compensation therefore, including **fringe benefits except retirement contributions or benefits** other than an employer payment of, or contributions to, premiums for group insurance coverage of retired employees or severance pay, and the employer’s personnel policies affecting the working conditions of the employees.

Minn. Stat. § 179A.03, subd. 19.

For bargaining purposes, the legislature recognized that pension contributions are a fringe benefit.

Second, under Minnesota law, a qualified deferred compensation plan is a supplemental pension plan. *See* Minn. Stat. § 356.24 (2008). In *Shaw v. Delta Airlines, Inc.*, 463 U.S. 85, 90, 103 S. Ct. 2890, 2896 (1983), the Supreme Court recognized that pension contributions are a fringe benefit:

The Federal Employee Retirement Income Security Act of 1974 (“ERISA”), 88 Stat. 829, as amended, 29 U.S.C. § 1001, et seq. (1976), subjects to federal regulation, plans providing employees with fringe benefits. ERISA is a comprehensive statute designed to promote interest of employees and their beneficiaries and employee benefit plans.

Shaw v. Delta Airlines, 463 U.S. at 90.

In *Morrison-Knudsen Construction Company v. United States Department of Labor*, 461 U.S. 624, 103 S. Ct. 2045 (1983), the court dealt with the interpretation of the term “wages” under the Longshoreman’s Workers’ Compensation Act. At issue was whether “wages” included employer contributions to benefit plans. Throughout the decision, the Court referred to pension contributions as fringe benefits. *See* 461 U.S. at 632-633, 103 S. Ct. at 2050. The court found that, unlike some other federal programs, fringe benefits, such as employer contributions to benefit plans, were not compensation under the Longshoreman’s Act. *Id.*

In *Public Employees Retirement System of Ohio v. Betts*, 492 U.S. 158, 174, 109 S. Ct. 2854, 2865 (1989), a case involving employment discrimination, the Court used the terms “employer’s contribution to a benefit plan” and fringe benefit interchangeably, and cited with approval the “EEOC’s” definition of an employee benefit plan for “EEOC” purposes:

Bona fide employee benefit plan.

...
(A)n “employee benefit plan” is a plan, such as a retirement, pension, or insurance plan, which provides employees with what are frequently referred to as

“fringe benefits.” The term does not refer to wages or salary in cash; neither section 4(f)(2) nor any other section of the Act excuses the payment of lower wages or salary to older employees on account of age.

29 CFR § 1625.10(b)(2009). *Public Employees Retirement System of Ohio v. Betts*, 492 U.S. at 174, 109 S. Ct. at 2865. *See also, Firefighters Local Union No. 1784 v. Stotts*, 467 U.S. 561, 570, 104 S. Ct. 2576, 2583 (1984) (referring to compensation and fringe benefits in the disjunctive, “greater monetary compensation or fringe benefits”).

For purposes of the federal “Davis Bacon Act” and state prevailing law wages commonly referred to as “Little Davis Bacon Acts,” pension benefits are considered both a “fringe benefit” and a wage supplement. *See United States of American v. Coren*, August 29, 2008, (unpublished) USDC New York (2008), 2008 WL 4488995, copy attached. Under the federal Davis Bacon Act, distinction is made between regular wages or basic hourly rate of pay and other fringe benefits, including pension contributions. *See* 480 U.S.C. § 3141 (2).

The federal bankruptcy scheme distinguishes between “salary and wages” and “fringe benefits.” Fringe benefits under the Bankruptcy Code include pension contributions. In *Howard Delivery Service, Inc. v. Zurich American Ins. Co.*, 547 U.S. 651, 126 S. Ct. 2105, 2106 (2006), the Supreme Court recognized the distinction between wages and fringe benefits for purposes of bankruptcy priorities. In that case, the court also recognized that under most workers’ compensation plans, “compensation” was a distinctive term as was the term “fringe benefits” which included pension plan benefits:

The bankruptcy code accords a priority, among unsecured creditors claims, for unpaid “wages, salaries, or commissions,” 11 U.S.C. § 507(a)(4)(A), and for unpaid contributions to “an employee benefit plan.” Section 507(a)(5). It is uncontested here that section 507(a)(5) covers fringe benefits that complete a pay package--typically pension plans, and group health, life, and disability insurance--whether unilaterally provided by an employer are the result of collective bargaining.

Howard Delivery Service, Inc., 547 U.S. at 654.

The IRS has published a lengthy booklet on “Fringe Benefits,” and by way of definition simply states: “a fringe benefit is a form of pay for the performance of services.” See IRS Publication 15B (2010), Employer’s Tax Guide to Fringe Benefits. The IRS publication, Public Employer Tax Guide, states that fringe benefits include “any compensation other than cash wages.” IRS, Federal, State and Local Governments, Public Employer Tax Guide (2008), ch 7, Fringe Benefits (2008).

In its “Taxable Fringe Benefits Guide” (copy attached), under the section, What Is A Fringe benefits, the IRS includes:

Tax-Deferred--benefit is not taxable when received but subject to tax later. For example, employer contributions to an employee’s pension plan may not be taxable when made, but may be taxed when distributed to the employee. *IRC § 402(a)*.

Taxable Fringe Benefits Guide, page 5.

The City of Duluth’s deferred compensation contributions are fringe benefits. When the PERA law was amended in 1994 to specifically exclude, “employer-paid fringe benefits,” that change should have alerted the City of Duluth’s and Petitioners’ bargaining representatives to obtain a formal response from PERA regarding the salary status of the City’s contributions rather than assuming their status as salary.

III. OTHER CONTRIBUTIONS BY THE CITY ARE ALSO FRINGE BENEFITS.

PERA does not believe the terms such as “cafeteria plan, flexible spending accounts, need be addressed. These are basic terms used in Petitioners’ CBAs and are defined under IRS law. The IRS definitions of “cafeteria plan” and “flexible spending account” are set forth in PERA’s initial Memorandum of Law, pages 15 through 18. They are also addressed in the IRS’ Taxable Fringe Benefit Guide. The Guide explains salary reduction agreements, flexible

spending arrangement and cafeteria plans. See “Taxable Fringe Benefit Guide” at 25, as does the IRS’ FAQs for Government Entities Regarding Cafeteria Plans, copy attached.

To the extent Petitioners directed the contributions, “towards the cost of medical premiums,” those contributions fall squarely within the first clause of section 353.01, subd. 10(b)(2), which excludes “employer-paid amounts used by an employee towards the cost of insurance coverage.” Minn. Stat. § 353.01, subd. 10(b)(2).

To the extent Petitioners continue to claim that they had no medical insurance coverage, heed should be taken of Justice Stevens dissenting opinion in *The District of Columbia v. The Greater Washington Bd. of Trade*, 506 U.S. 125, 133, 113 S. Ct. 585 (1992), an ERISA pre-emption case in which he twice referred to medical insurance as a fringe benefit:

In today’s world, the typical employee’s compensation is not just her take home pay, it often includes fringe benefits such as vacation pay and health insurance. . . (h)er entire loss of earnings-including the value of fringe benefits such as health insurance.

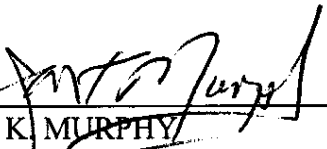
District of Columbia (dissenting opinion), 506 U.S. at 133, 113 S. Ct. at 586.

To the extent Petitioners chose to direct the employer's contributions to tax favored accounts other than deferred compensation, those contributions are also "employer-paid fringe benefits" and are excluded from PERA's definition of salary.

Dated: Apr. 1 20, 2010

Respectfully submitted

LORI SWANSON
Attorney General
State of Minnesota



JON K. MURPHY
Assistant Attorney General
Atty. Reg. No. 0076508
445 Minnesota Street, Suite 900
St. Paul, MN 55101-2127
(651) 757-1385 (Voice)
(651) 296-1410 (TTY)

ATTORNEYS FOR PERA
BOARD OF TRUSTEES

Taxable Fringe Benefit Guide

**FEDERAL, STATE, AND LOCAL GOVERNMENTS
THE INTERNAL REVENUE SERVICE**

January 2010

1 Introduction

2 Reporting Fringe Benefits

3 Working Condition Fringe Benefits

4 De Minimis Fringe Benefit

5 No-Additional-Cost Fringe Benefits

6 Qualified Employee Discount

7 Qualified Transportation Fringe Benefits (QTF)

8 Health and Medical Benefits

9 Travel and Transportation Expenses

10 Moving Expenses

11 Meals and Lodging

12 Use of Employee-Owned Vehicle

13 Employer-Provided Vehicle

14 Independent Contractors

15 Equipment and Allowances

16 Other Types of Compensation

17 Awards and Prizes

18 Professional Licenses and Dues

19 Volunteers

20 Educational Reimbursements and Allowances

Appendix: Charitable Contributions to Governments

Appendix: Contact Information

INDEX

1 Introduction

The Taxable Fringe Benefits Guide was created by the Internal Revenue Service office of Federal, State and Local Governments (FSLG) to provide governmental entities with a basic understanding of the Federal tax rules relating to employee fringe benefits and reporting.

Used as a supplement to other IRS publications, the Fringe Benefit Guide can be a helpful tool for anyone responsible for determining the taxability, withholding, and reporting requirements regarding employee fringe benefits.

This publication covers:

- The tax treatment, reporting and withholding of common employer-provided fringe benefits.
- General procedures for computing the taxable value of fringe benefits.
- Reporting the taxable value of benefits on Forms W-2 and 1099-MISC.
- Additional Federal reporting requirements that are in effect for certain fringe benefits.
- Procedures for obtaining answers from the Internal Revenue Service to questions regarding taxation and reporting requirements.

NOTICE

This guide is intended to provide basic information on the subjects covered. It reflects the interpretation by the IRS of tax laws, regulations, and court decisions. The explanations in the guide are intended for general guidance only, and are not intended to provide a specific legal determination with respect to a particular set of circumstances. Additional research may be required before a determination may be made on a particular issue. Citations to legal authority are included in the text. You may contact the IRS for additional information. You may also want to consult a tax advisor to address your situation.

What Is a Fringe Benefit?

A fringe benefit is a form of pay (including property, services, cash or cash equivalent) in addition to stated pay for the performance of services. Some forms of additional compensation are specifically designated as “fringe benefits” in the Internal Revenue Code; others, such as moving expenses or awards, have statutory provisions providing for special tax treatment but are not so designated by the Code. This publication uses the term broadly to refer to all remuneration other than stated pay for which special tax treatment is available. The definition of fringe benefits applies to services of employees and independent contractors; however, unless otherwise indicated, this guide applies to fringe benefits provided by an employer to an employee. (For a discussion of whether a worker is an employee or independent contractor, see Publication 15-A.) Fringe benefits for employees are taxable wages unless specifically excluded by a section of the Internal Revenue Code (IRC). *IRC §61 IRC §3121, 3401; IRC §61(a)(1)*

The IRC may provide that fringe benefits are nontaxable, partially taxable, or tax-deferred. These terms are defined below.

Taxable – Includible in gross income unless excluded under an IRC section. If the recipient is an employee, this amount is includible as wages. For example, bonuses are always taxable because no IRC section excludes them from taxation.

Nontaxable (excludable) – Excluded from wages by a specific IRC section; for example, qualified health plan benefits excludable under section 105.

Partially taxable - Part is excluded by IRC section and part is taxable. Benefits may be excludable up to dollar limits, such as the public transportation subsidy under IRC §132.

Tax-deferred – Benefit is not taxable when received, but subject to tax later. For example, employer contributions to an employee's pension plan may not be taxable when made, but may be taxed when distributed to the employee. *IRC §402(a)*

More than one IRC section may apply to the same benefit. For example, education expenses up to \$5,250 may be excluded from tax under IRC §127. Amounts exceeding \$5,250 may be excluded from tax under IRC §132.

A benefit provided on behalf of an employee is taxable to an employee even if the benefit is received by someone other than the employee, such as a spouse or a child. *Reg. § 1.61-21(a)(4)*

“Taxable” means the benefit is included in the employees' wages and reported on Form W-2, Wage and Tax Statement, and generally is subject to Federal income tax withholding, social security (unless the employee has already reached the current year wage base limit), and Medicare. An employer's matching contribution is required for social security and Medicare.

If an employee's wages are not normally subject to social security or Medicare taxes (for example, because the employee is covered by a qualifying public retirement system), any taxable fringe benefits would also not be subject to social security or Medicare taxes.

General Valuation Rule

Generally, taxable fringe benefits are valued at their fair market value (FMV). FMV is the amount a willing buyer would pay an unrelated willing seller, neither one forced to conduct the transaction and both having reasonable knowledge of the facts. In many cases, the cost and FMV are the same; however, there are many situations in which FMV and cost differ, such as when the employer incurs a cost less than the value to provide the benefit. *Reg. §1.61-21(b)*

FMV of a benefit is reduced by any amount paid by or for the employee. For example, an employee has a taxable fringe benefit with a fair market value of \$3.00 per day. If the employee pays \$1.00 per day for the benefit, the taxable fringe benefit is \$2.00 per day.

Special valuation rules apply for certain fringe benefits and will be covered in other chapters.

IRC Sections Excluding Fringe Benefits

The following Code sections provide a statutory basis for specific benefits. They are discussed later in the text.

- §104 – Amounts received as health reimbursements from employer
- §106 – Health insurance premiums paid by employer
- §117(d) - Qualified tuition reductions
- §119 - Meals or lodging for employer's convenience
- §125 - Cafeteria plans
- §127 - Educational assistance program
- §129 - Dependent care assistance program
- §132 – Specifies certain fringe benefits, if not covered by another Code section, including:
 - §132(b) - No additional-cost service
 - §132(c) - Qualified employee discounts
 - §132(d) - Working condition fringe
 - §132(e) - De minimis benefit
 - §132(f) - Qualified transportation expenses
 - §132(g) - Qualified moving expense reimbursements
 - §132(m) - Qualified retirement planning services
 - §132(n) – Qualified military base realignment and closure fringe

2 Reporting Fringe Benefits

In general, taxable fringe benefits are reported when received by the employee and are included in employee wages in the year the benefit is received. However, there are many special rules and elections for different benefits, discussed in this section. *IRC 451(a); IRS Ann. 85-113, 1985-31*

Employer's Election of When To Withhold

The employer may elect to treat taxable fringe benefits as paid in a pay period, quarterly, semiannual, or annual basis, but no less frequently than annually.

IRS Ann. 85-113, 1985-31

Alternative Rule for Income Tax Withholding

The employer may elect to add taxable fringe benefits to employee regular wages and withhold on the total, or may withhold on the benefit at the supplemental wage rate of 25%.

Reg. §31.3402(g)-1; Reg. §31.3501(a)-1T

Special Accounting Period

Under a special rule, benefits provided in November and December, or a shorter period in the last 2 months of the year, may be treated as paid in the following year. Only the value of benefits actually provided during the last 2 months may be treated as paid in the subsequent year. You do not have to notify the IRS that you are using this special accounting rule. *IRS Ann. 85-113*

An employer may use this rule for some fringe benefits and not others. The special accounting period need not be the same for each fringe benefit. However, if an employer uses the special accounting period rule for a particular benefit, the rule must be used for all employees who receive the same fringe benefit.

Employer's Election Not To Withhold Income Tax

An e may elect not to withhold **income taxes** on the taxable use of an employer's vehicle that is includible in wages if: (1) the employer notifies the employee, and (2) the employer includes the benefit in the employee's wages on the Form W-2 and withholds social security and Medicare tax. *IRC §3402(s)(1)*

Note: This election is available for employer-provided vehicles only. In general, an employer does not have a choice whether to withhold on taxable fringe benefits.

4 De Minimis Fringe Benefits

De minimis fringe benefits include property or services, provided by an employer for an employee, with a value so small that accounting for it is unreasonable or administratively impractical. The value of the benefit is determined by the frequency it is provided to each individual employee, or, if this is not administratively practical, by the frequency provided by that employer to the workforce as a whole. *IRC §132(e); Reg. §1.132-6(b)*

Example: An employer gives employees snacks each day valued at 75 cents. Even though small in amount, the benefit is provided on a regular basis and is, therefore, taxable as wages.

The law does not specify a dollar threshold for benefits to qualify as de minimis. The determination will always depend on facts and circumstances. The IRS has given advice at least once (ILM 200108042) that a benefit of \$100 did not qualify as de minimis. However, this technical advice addresses a specific situation and cannot be relied upon in addressing another specific situation.

Examples of Excludable De Minimis Fringe Benefits: *Reg. §1.132-6(e)(1)*

Occasional (infrequent), *not routine*

- Personal use of photocopier (with restrictions)
- Group meals, employee picnics
- Theater or sporting event tickets
- Coffee, doughnuts, or soft drinks
- Flowers or fruit for special circumstances
- Local telephone calls
- Traditional birthday or holiday gifts (not cash) with a low FMV
- Commuting use of employer's car if no more than once per month

The following do not qualify as De Minimis Fringe Benefits

- Cash - except for occasional and infrequent meal money to allow overtime work
- Cash equivalent (i.e., savings bond, gift certificate for general merchandise at a department store)
- Certain transportation passes or costs
- Use of employer's apartment, vacation home, boat
- Commuting use of employer's vehicle more than once a month. *Reg. §1.132-6(d)(3)*
- Membership in a country club or athletic facility

Some of these benefits may be excludable under other provisions of the law.

Example: Maddy buys a transit pass for \$120 each month in 2010. At the end of each month, she presents her used transit pass to her employer and certifies that she purchased and used it during the month. The employer reimburses her \$120. Lulu also purchases a monthly transit pass for \$120, but presents it to her employer at the beginning of the month and certifies that she purchased it and will use it during the month. Her employer reimburses her at the time she presents the transit pass. In both situations, the employer has established a bona fide reimbursement arrangement for purposes of excluding the \$120 reimbursement from the employee's gross income in 2010.

Qualified Parking

Qualified parking is parking provided to employees on or near the business work premises, or parking on or near a location from which employees commute to work by commuter highway vehicle, mass transit station, or vanpool. *IRC §132(f)(5)(C)*

Maximum nontaxable value is \$230 per month in 2010. *IRC §132(f)(2)(B); Rev. Proc. 2009-50*

Qualified Bicycle Commuting Expenses

Beginning with years after 2008, employees may exclude reimbursements paid by employers for qualified bicycle commuting expenses. The maximum exclusion is \$20 times the number of months the employee uses a bicycle for commuting to work. Allowable expenses include the purchase, maintenance, repair and storage expenses related to bicycle commuting. *IRC 132(f)(1)(D)*

The bicycle commuting expense exclusion cannot be claimed for any period in which the exclusion for public transit passes or qualified parking is claimed. *IRC 132(f)(1)(F)(iii)(II)*

Salary Reduction Agreements

A salary reduction agreement is a way to provide QTF benefit pre-tax to employees, without additional cost to the employer. An employee can choose between receiving a fixed amount of taxable cash or QTF for a specified future period. A QTF salary reduction plan need not be in writing; but the election by the employee must be in writing or another permanent form, such as electronic. *IRC §132(f)(4); Regs. 1.132-9 Q&A 11-15*

Note: QTFs are prohibited benefits under cafeteria plan rules. You cannot include these benefits as part of a cafeteria plan. *Reg. §1.132-1(b)(2)(i)*

The election under a salary reduction agreement must contain the following:

- Date of the election,
- Amount of compensation to be reduced, and the
- Period for which the election is valid.

Limitations

The salary reduction may not exceed the combined applicable statutory monthly limits for QTFs. For the calendar year 2010, the limitation is \$460 (\$230 + \$230).

This election may not be revoked after the employee is currently able to receive the cash or after the beginning of the period for which the QTF is to be provided. Any unused QTF may not be refunded. However, the unused portion may be carried over to subsequent periods and used to provide QTFs as long as the amount expended does not exceed annual limits.

Negative Election

A negative election is permitted, if the employee receives adequate notice that a salary reduction will be made and is given adequate opportunity to choose to receive cash compensation instead of the QTF. A negative election means that no response is treated as a "Yes" vote; that is, the employee wants the QTF and does NOT choose the cash.

Example: Agency Y maintains a QTF benefit arrangement. Employees of Y are paid twice per month, with the payroll dates being the 10th and 25th day of the month. Employee Q elects, before the first day of the month, to reduce his compensation in return for QTFs totaling \$250 through the year 2010 (for qualified parking). Because the election was made before he could receive the cash and the election is for a specific period, the arrangement satisfies the requirements for a valid salary reduction.

Example: In the above example, if employee Q revoked his election on the 10th of the month, it would be effective for the second pay period, since the revocation cannot be effective during a current pay period. It must be for a future period.

Effect on Deferred Compensation Plans

When employees participate in a deferred compensation plan, they are limited to a percentage of their compensation annually that they may contribute. In computing what is considered compensation for purposes of the limitation, an employer may exclude certain fringe benefits, including QTFs. *IRC §314(e) IRC §403(b)(3); IRC §414(s)(2)&(3); IRC §415(c)(3); IRC §125*

Other Local Transportation Benefits

Three other local transportation fringe benefits allow employers to provide transportation for commuting to employees that is excludable from wages or taxed at \$1.50 each way:

- Occasional cab fare
- Unusual circumstances
- Unsafe conditions

8 Health and Medical Benefits

Under IRC sections 104, 105 and 106, employer-provided health benefits, including reimbursement and insurance, are generally excluded from the income of the employees. This applies to any employer-paid system, whether it is made directly (i.e., self-insured) to the employees or through an insurance provider or a trust. However, if the plan discriminates in favor of highly compensated employees, the amounts paid to those employees are subject to Federal income tax. *IRC § 105(h)*

Direct reimbursement or payment - An employer may pay employee or reimburse qualifying medical expenses, without taxable income to the employee. These payments may be made with or without a written plan. This includes payments for specific injuries or illness, but not payments based on work missed (i.e., sick pay). *IRC §105*

Health Reimbursement Arrangement (HRA) - An HRA is a written plan to provide employer payment or reimbursement for qualifying medical or health benefits. It may provide for the carryover of benefits from year to year, and may specify the types of medical benefits that are covered. An HRA can only be financed by employer contributions, and cannot involve an employee election to participate. For more information, see [Publication 969](#). *IR C§105(b); IR C §106; Notice 2002-45*

Employer contributions to health plans – Contributions to the cost of accident or health insurance, including qualified long-term care insurance. Health insurance paid by an employer is excludable from the income of employees. This includes employer contributions to an Archer Medical Savings Account (MSA) account or to a health savings account (HSA). See [Publication 969](#) for more information on these plans. *IRC §106*

Flexible Spending Arrangement – Under a written employer plan, the employee may choose to reduce salary and contribute to an account for medical expenses on a pre-tax basis. Amounts in the account may be used to pay for qualifying medical expenses, generally only within that calendar year. Long-term care benefits are not excludable from income tax, but are excludable from social security and Medicare taxes. *IRC §106(c)(2)*

Cafeteria plan - A cafeteria plan, which may include a flexible spending arrangement, is a written benefit plan that meets the requirements under section 125, under which employees can choose from among cash and certain qualified benefits. Benefits provided under a cafeteria plan are subject to social security and Medicare taxes on the same basis as the specific benefits would be if provided outside the plan. If the employee elects qualified benefits, employer contributions are excluded from wages for income tax purposes if the benefits are excludable from gross income under a specific section of the Internal Revenue Code (other than scholarship and fellowship grants under section 117 and employee fringe benefits under section 132). *IRC §125*

For more information, see [Publication 15-B](#), [Publication 963](#), and the [Cafeteria Plans Q&A](#) on the FSLG web page. *IR C§125*



FAQs for government entities regarding Cafeteria Plans

These frequently asked questions and answers are provided for general information only and should not be cited as any type of legal authority. They are designed to provide the user with information required to respond to general inquiries. Due to the uniqueness and complexities of Federal tax law, it is imperative to ensure a full understanding of the specific question presented, and to perform the requisite research to ensure a correct response is provided.

The freely available [Adobe Acrobat Reader](#) software is required to view, print, and search the questions and answers listed below.

1. [What is a cafeteria plan?](#)
 2. [Who may receive benefits under a cafeteria plan?](#)
 3. [Is there a filing requirement for a town that maintains a cafeteria plan?](#)
 4. [How does a cafeteria plan work?](#)
 5. [What is a flexible spending arrangement?](#)
 6. [A town has a cafeteria plan \(section 125 plan\), which offers dependent care assistance. The benefits received by an employee exceed \\$5,000. How is this benefit reported on Form W-2?](#)
 7. [What remuneration under a cafeteria plan is not subject to social security, Medicare, FUTA, or income tax withholding?](#)
 8. [Can a cafeteria plan make advance reimbursements for medical expenses?](#)
 9. [A town has a cafeteria plan which offers health care benefits to domestic partners. Does a domestic partner and his or her child qualify to be covered under the health plan?](#)
-

What is a cafeteria plan?

A cafeteria plan is a separate written plan maintained by an employer for employees that meets the specific requirements of and regulations of section 125 of the Internal Revenue Code. It provides participants an opportunity to receive certain benefits on a pretax basis. Participants in a cafeteria plan must be permitted to choose among at least one taxable benefit (such as cash) and one qualified benefit.

A qualified benefit is a benefit that does not defer compensation and is excludable from an employee's gross income under a specific provision of the Code, without being subject to the principles of constructive receipt. Qualified benefits include:

- Accident and health benefits (but not Archer medical savings accounts or long-term care insurance);
- Adoption assistance;
- Dependent care assistance;
- Group-term life insurance coverage;
- Health savings accounts, including distributions to pay long-term care services.

The written plan must specifically describe all benefits and establish rules for eligibility and elections.

A section 125 plan is the only means by which an employer can offer employees a choice between taxable and nontaxable benefits without the choice causing the benefits to become taxable. A plan offering only a choice between taxable benefits is not a section 125 plan.

[Return to List of FAQs](#)

Who may receive benefits under a cafeteria plan?

The plan may make benefits available to employees, their spouses and dependents. It may also include coverage of former employees, but cannot exist primarily for them. See the questions below for treatment of benefits made available to individuals who are not spouses or dependents of the employee.

[Return to List of FAQs](#)

Is there a filing requirement for a cafeteria plan?

Generally, no. If you only have a cafeteria plan, you are not required to file Form 5500 or Schedule F. However, if you have a welfare benefit plan, you may be required under Department of Labor regulations to file a return for that plan. Please see the [Form 5500 Instructions](#) or contact the U.S. Department of Labor for more information. Assistance is also available from our [Customer Account Services](#) office.

[Return to List of FAQs](#)

How does a cafeteria plan work?

Employer contributions to the cafeteria plan are usually made pursuant to salary reduction agreements between the employer and the employee in which the employee agrees to contribute a portion of his or her salary on a pre-tax basis to pay for the qualified benefits. Salary reduction contributions are not actually or constructively received by the participant. Therefore, those contributions are not considered wages for federal income tax purposes. In addition, those sums generally are not subject to FICA and FUTA. See Sections 3121(a)(5)(G) and 3306(b)(5)(G) of the Internal Revenue Code.

The above discussion provides only the most basic rules governing a cafeteria plan. For a complete understanding of the rules, see the Proposed Regulations under Code section 125.

[Return to List of FAQs](#)

What is a flexible spending arrangement?

A flexible spending arrangement (FSA) is a form of cafeteria plan benefit, funded by salary reduction, that reimburses employees for expenses incurred for certain qualified benefits. An FSA may be offered for dependent care assistance, adoption assistance, and medical care reimbursements. The benefits are subject to an annual maximum and are subject to an annual "use-or-lose" rule. An FSA cannot provide a cumulative benefit to the employee beyond the plan year.

[Return to List of FAQs](#)

A town has a cafeteria plan (section 125 plan), which offers dependent care assistance. The benefits received by an employee exceed \$5,000. How is this benefit reported on Form W-2?

An employee can generally exclude from gross income up to \$5,000 of benefits received under a dependent care assistance program each year. The limit is reduced to \$2,500 for married employees filing separate returns. The exclusion cannot be more than the earned income of either the employee or the employee's spouse. The total dependent care benefits the employer paid to the employee or incurred on the employee's behalf (including amounts from a section 125 plan) should be reported in Box 10 of Form W-2. Any amount over \$5,000 should be

FACTS from EBRI

Employee Benefit Research Institute ■ 2121 K Street, NW, Suite 600 ■ Washington, DC ■ 20037

May 2007

Flexible Spending Accounts

- Internal Revenue Code (IRC) Sec. 125, created by the Revenue Act of 1978, formally introduced tax-qualified flexible benefit plans. These plans include all those that offer employees a choice between at least one qualified nontaxable benefit and one taxable benefit (including cash). Sec. 125 allows employers to provide employees with a choice among benefits without requiring them to include the value of the benefits in their adjusted gross income unless they choose taxable options.
- There are three types of qualified plans under Sec. 125: flexible spending accounts (FSAs), premium conversion plans (which allow employees to make their contribution to the premium of the health plans with pretax dollars), and cafeteria plans. This Fact Sheet describes flexible spending accounts.
- Flexible spending accounts (FSAs) may exist as stand-alone plans or within a cafeteria plan. Employees choose how much money they want to contribute to an FSA at the beginning of the plan year. To the extent that these funds are not used during the plan year, they are forfeited. There are two types of FSAs: a *health care* spending account and a *dependent care* spending account. Employers may offer employees one or both types, but the money contributed to each must be treated separately.

Health Care Spending Account

- There are no legal limits on contributions to a health care FSA, but a plan sponsor may set a limit. An employee determines before the beginning of a calendar year how much money he or she wishes to contribute in the calendar year ahead. The employer deducts equal installments from each paycheck consistent with the designated yearly amount. Under the uniform reimbursement requirement, the amount for eligible medical expenses under a health care FSA must be available at all times during the year.
- Allocation of unused portions of an FSA is at the plan sponsor's discretion. By law, the only action a plan sponsor may not take is returning the unused portion to the employee. The employee forfeits any claim to the unused portion. However, because of the uniform reimbursement requirement, if an employee uses the entire amount in the FSA before the end of the calendar year and leaves employment with that employer, he or she does not have to reimburse the employer the difference between what was contributed, up to that point, and the amount used.
- According to a study by Mercer Human Resource Consulting, in 2005, 26 percent of employers with 10 or more employees offered a health care FSA, and 35 percent of eligible employees were participating.
- In 2005, the average contribution to a health care FSA was \$1,235 among employees in all firms participating in a health care FSA.
- An employer that offered a health care FSA in 2005 could have a net tax saving of \$1,987. This figure is based on an employer of 100 employees, with an average salary of \$30,000, in which 21 percent of employees participate in the health care FSA, with each contributing \$1,237.^a
- An employee making \$35,000 a year, who contributed to a health care FSA (the average amount of \$1,235), would see a net tax savings of \$282.^b (The standard deduction and federal income tax are based on an individual claiming a deduction as a single under age 65.)
- Medical expenses that qualify under IRC Sec. 213 may be reimbursed through a health care FSA. Sec. 213 defines medical expenses to include amounts paid for the diagnosis, treatment, or prevention of disease, and for treatments affecting any part or function of the body. The expenses must be for the alleviation or prevention of a physical defect or illness.

- In September 2003, the IRS issued a revenue ruling stating that over-the-counter medications may be reimbursable through a health care FSA. Since some medications that can be bought over the counter today were recently available only through a doctor's prescription (such as Claritin), the IRS reasoned that including over-the-counter medications as a reimbursable expense is consistent with the definitions of medical expenses in Sec. 213. However, items such as vitamins and dietary supplements are not reimbursable.

Dependent Care Spending Account

- Contributions to a dependent care FSA are limited by law to no more than \$5,000 a year. Allocation of the unused assets in a dependent care FSA is treated in the same manner as the allocation for the health care FSA (meaning that they are forfeited). One notable exception is that the uniform reimbursement requirement does not apply to dependent care FSAs.

- An eligible dependent is defined as an individual who can be claimed by an employee as a dependent for federal tax purposes under IRC Sec. 151(c) and meets the following requirements:

- Child under age 13.
- An individual, such as a disabled parent, who requires full-time care because of a physical or mental incapacity.
- An employee's spouse who is physically or mentally incapable of caring for himself or herself.

Expenses for care outside of the taxpayer's home may be claimed only for dependents who are under age 13 or who regularly spend eight hours per day in the taxpayer's home.

- According to a study by Mercer Human Resource Consulting, in 2005, 27 percent of employers with 10 or more employees offered a dependent care FSA, and 14 percent of eligible employees were participating.

- In 2005, the average contribution to a dependent care FSA was \$2,630 among employees in all firms participating in a dependent care FSA.

- An employer that offered a dependent care FSA in 2005 could have a net tax saving of \$4,141 per year. This figure is based on an employer of 100 employees with an average salary of \$30,000 in which 21 percent of employees participate in the dependent care FSA, each contributing \$2,579.^c

- An employee making \$35,000 a year, who contributed to a dependent care FSA (the average amount of \$2,630), would see a net tax savings of \$770.^b (The standard deduction and federal income tax are based on an individual claiming a deduction as head of household plus one dependent under age 65).

For more information, contact Ken McDonnell, (202) 775-6342, or see EBRI's Web site at www.ebri.org

Sources: Employee Benefit Research Institute, *EBRI Databook on Employee Benefits*, fourth edition (Washington, DC: Employee Benefit Research Institute, 1997); Mercer Human Resource Consulting, *National Survey of Employer-Sponsored Health Plans: 2005 Survey Tables* (New York: Mercer Human Resource Consulting, 2005).

^a The amount of \$1,237 is for firms with 10 to 499 employees. The amount of \$1,235 is for all firms with 10 or more employees.

^b Calculations are based on an individual in the 15 percent federal tax bracket plus 7.65 percent FICA tax contributions. State income taxes are left out of this calculation due to the high variance in state income tax rates.

^c The amount of \$2,579 is for firms with 10 to 499 employees. The amount of \$2,630 is for all firms with 10 or more employees.

FS-201

Internal Revenue Service Regulation 1.125-2

Miscellaneous cafeteria plan questions and answers

§1.125-2 Miscellaneous cafeteria plan questions and answers, EE-130-86, 3/7/89 and REG-209461-79, 1/10/2001.

The following is a list of the questions addressed in this section.

Q-1: What are the effective dates of these cafeteria plan rules?

Q-2: What does section 125 of the Code provide?

Q-3: What is a cafeteria plan under section 125?

Q-4: What benefits constitute qualified benefits and what benefits constitute cash under a cafeteria plan?

Q-5: May a cafeteria plan include a benefit that defers the receipt of compensation?

Q-6: In what circumstances may participants revoke existing elections and make new elections under a cafeteria plan?

Q-7: How do the rules governing the tax-favored treatment of employer-provided benefits apply to plans that are flexible spending arrangements?

Q-1: What are the effective dates of these cafeteria plan rules?

A-1: Q&A-1 through Q&A-6 of this §1.125-2 apply to plan years of cafeteria plans as set forth in Q&A-10 of §1.89(a)-1 (regarding the effective date of section 89). Q&A-7 of this §1.125-2 (relating to flexible spending arrangements) applies to plan years beginning after December 31, 1989.

Q-2: What does section 125 of the Code provide?

A-2: In general, an employee who has an election among nontaxable benefits and taxable benefits (including cash) must include in gross income any taxable benefits that the employee could have actually received pursuant to the employee's election. The amount of these benefits is included in the employee's income in the year in which the employee would have actually received the taxable benefits if the employee had elected such benefits. This generally is the result even if the employee's election between the nontaxable benefits and taxable benefits is made prior to the year in which the employee would have actually received the taxable benefits. However, section 125 provides that cash (including certain taxable benefits) provided under a nondiscriminatory cafeteria plan will not be included in a participant's gross income merely because the participant has the opportunity, before the cash becomes currently available to the participant, to choose among cash and the nontaxable benefits under the cafeteria plan.

Q-3: What is a cafeteria plan under section 125?

A-3: A cafeteria plan is a plan maintained by an employer for the benefit of its employees that satisfies the requirements of section 89(k), under which all participants are employees, and under which each participant has the opportunity to choose among cash and qualified benefits. Additionally, a cafeteria plan satisfies the written plan document requirement of clause (v) of Q&A-3 of §1.125-1 only if the plan describes the maximum amount of elective contributions available to any employee under the plan either by stating the maximum dollar amount or maximum percentage of compensation that may be contributed as elective contributions under the plan by employees or by stating the method for determining the maximum amount or percentage of elective contributions that employees may make under the plan. The meaning of "elective contributions" under a cafeteria plan is the same as the meaning of "salary reduction contributions" under a cafeteria plan. See also paragraph (a)(2) of Q&A-8 of §1.89(a)-1.

Q-4: What benefits constitute qualified benefits and what benefits constitute cash under a cafeteria plan?

A-4: (a) *Qualified benefits*—(1) *In general.* A benefit is a qualified benefit under a cafeteria plan if the benefit does not defer the receipt of compensation and the benefit is not includible in an employee's gross income by reason of an express provision of Chapter 1 of the Code. In the case of insurance-type benefits, such as benefits provided under accident or health plans (sections 106 and 105) and group-term life insurance plans (section 79), the benefit is the coverage under the plan.

(2) *Items that constitute qualified benefits*—(i) *Accident or health plans.* Coverage under an accident or health plan is a qualified benefit to the extent that such coverage is excludable from income under section 106. Thus, for example, coverage under a long-term disability plan and coverage under an accidental death and dismemberment policy may be qualified benefits.

(ii) *Group-term life insurance.* Group-term life insurance coverage that is excludable from gross income under section 79 and group-term life insurance coverage that is includible in gross income solely because the death benefit payable thereunder is in excess of the dollar limit of section 79 are qualified benefits.

(iii) *Certain discriminatory benefits.* Accident or health plan coverage, group-term life insurance coverage, and benefits under a dependent care assistance program do not fail to be qualified benefits under a cafeteria plan merely because they are includible in gross income solely because of section 89 or any other applicable nondiscrimination requirement (e.g., section 129(d)).

(iv) *Certain dependent care assistance benefits.* Benefits under a dependent care assistance program that would have been excludable from gross income under section 129 but for the elimination of overnight camp expenses from dependent care assistance under such section (effective January 1, 1988) or the reduction of the age limit on children qualifying as dependents under such section (effective January 1, 1989) do not fail to be qualified benefits merely because such changes in law cause such benefits to be taxable. However, the preceding sentence applies only if the benefits are provided under a program that otherwise qualifies as a dependent care assistance program under section 129, are taxable to the employee upon receipt, and are provided by the December 31 next following the effective date of the applicable change in law. After such date, such benefits will not constitute qualified benefits but may be treated as cash pursuant to paragraph (b) of this Q&A-4.

(b) *Currently taxable benefits treated as cash.* In general, a benefit is treated as cash if such benefit does not defer the receipt of compensation and an employee who receives such benefit purchases such benefit with after-tax employee contributions or is treated, for all purposes under the Code (including, for example, reporting and withholding purposes), as receiving, at the time that such benefit is received, cash compensation equal to the full value of such benefit at such time and then purchasing such benefit with after-tax employee contributions. Thus, for example, long-term disability coverage is treated as cash if the cafeteria plan provides that an employee may purchase the coverage under the plan with after-tax employee contributions, or provides that the employee receiving such coverage is treated as having received cash compensation equal to the value of the coverage and then as having purchased the coverage with after-tax employee contributions. Any taxable benefit that is not described in paragraph (a) of this Q&A-4 and is not treated as cash under this paragraph (b) may not be included in a cafeteria plan.

(c) *Qualified cash or deferred arrangements.* Elective contributions to a qualified cash or deferred arrangement (section 401(k)) are permitted under a cafeteria plan. In addition, after-tax employee contributions under a qualified plan subject to section 401(m) are permitted under a cafeteria plan. The right to make such contributions will not cause a plan to fail to be a cafeteria plan merely because, under the qualified plan, employer matching contributions are made with respect to elective or after-tax employee contributions.

(d) *Benefits that do not constitute qualified benefits or cash.* Benefits of the type described in section 117 or 132 do not constitute qualified benefits or cash and thus may not be included in a cafeteria plan regardless of whether any such benefit is purchased with after-tax employee contributions or on any other basis. Thus, for example, health diagnostic or examination plans are qualified benefits under a cafeteria plan because such plans

are accident or health plans that are eligible for the exclusion under section 106 and are not, in any case, eligible for the exclusion under section 132.

Q-5: May a cafeteria plan include a benefit that defers the receipt of compensation?

A-5: (a) *In general.* A cafeteria plan may not include any plan that offers a benefit that defers the receipt of compensation. In addition, a cafeteria plan may not operate in a manner that enables employees to defer compensation. For example, a plan that permits employees to carry over unused elective contributions or plan benefits (e.g., accident or health plan coverage) from one plan year to another operates to defer compensation. This is the case regardless of how the contributions or benefits are used by the employee in the subsequent plan year (e.g., whether they are automatically or electively converted into another taxable or nontaxable benefit in the subsequent plan year or used to provide additional benefits of the same type). Similarly, a cafeteria plan operates to permit the deferral of compensation if the plan permits participants to use contributions for one plan year to purchase a benefit that will be provided in a subsequent plan year (e.g., life, health, disability, or long-term care insurance coverage with a savings or investment feature, such as whole life insurance). For example, a cafeteria plan operates to permit the deferral of compensation if the cafeteria plan includes a health plan that is a flexible spending arrangement (as defined in Q&A-7 of this section) and such health plan may reimburse participants' premium payments for other accident or health coverage extending beyond the end of the plan year. See Q&A-7 of this section for the treatment of experience gains under a health plan that is a flexible spending arrangement.

(b) *Exceptions.* A plan does not fail to be a cafeteria plan merely because the plan permits participants to make elective contributions under a qualified cash or deferred arrangement under section 401(k) or permits participants employed by certain educational institutions to purchase retiree group-term life insurance. Similarly, a cafeteria plan does not include a benefit that defers the receipt of compensation merely because the cafeteria plan provides the opportunity to make after-tax employee contributions subject to section 401(m) under a qualified plan. In addition, a cafeteria plan will not be treated as including a benefit that defers the receipt of compensation merely because, under the qualified plan, employer matching contributions (as defined in section 401(m)(4)(A)) are made with respect to such elective contributions or after-tax employee contributions. Finally, reasonable premium rebates or policy dividends paid with respect to benefits provided under a cafeteria plan do not constitute impermissible deferred compensation if such rebates or dividends are paid before the close of the 12-month period immediately following the plan year to which such rebates and dividends relate.

(c) *Treatment of paid vacation days under a cafeteria plan—(1) In general.* A cafeteria plan may include elective, paid vacation days by permitting participants to receive either additional or fewer paid vacation days than the employer otherwise provides to the employees on a nonelective basis, if the inclusion of elective vacation days under the plan does not operate to permit the deferral of compensation.

(2) *Ordering of elective and nonelective vacation days.* In determining whether a plan that provides for paid vacation days operates to permit the deferral of compensation, and thus fails to be a cafeteria plan, a participant is deemed to use nonelective vacation days (i.e., the vacation days with respect to which the employee had no election) before elective vacation days.

(3) *Cashing out unused elective vacation days.* A plan does not operate to permit the deferral of compensation merely because the plan permits a participant who has not used all elective, paid vacation days for a plan year to receive in cash the value of such unused days in exchange for such days if the participant receives the cash on or before the earlier of the last day of the plan year of the cafeteria plan or the last day of the employee's taxable year to which the elective contributions used to purchase the unused days relate.

(4) *Examples.* The following examples illustrate the rules of this paragraph (c):

Example 1. Assume that an employer provides an employee with 2 weeks of paid vacation for each calendar year and maintains a calendar year cafeteria plan that permits the employee to "purchase," with elective contributions, an additional week of paid vacation. Assume further that Employee A, with a calendar tax year, purchases 1 additional week of vacation. If Employee A uses only 2 weeks of vacation during the year, the

employee is treated as having used the 2 nonelective weeks and as having retained the 1 elective week. If the 1 remaining week (i.e., the elective week) may be carried over to the next year (or the value thereof used for any other purpose in the next year), the plan operates to permit the deferral of compensation and thus is not a cafeteria plan. However, the cafeteria plan may permit the employee to receive the value of the unused elective vacation week in cash before the end of the applicable calendar year.

Example 2. The facts are the same as set forth in Example 1, except that Employee A uses only 1 week of vacation during the year. Thus, Employee A is treated as having used 1 nonelective week and as having retained 1 nonelective week as well as 1 elective week of vacation. Because the nonelective vacation days are not part of the cafeteria plan (i.e., the employer or plan does not permit participants to exchange regular vacation days for other benefits), Employee A may be permitted to carry over the 1 nonelective week of vacation to the next year. In addition, under the terms of the cafeteria plan, Employee A must either forfeit the remaining elective vacation week or receive in cash the value of such unused days before the end of the applicable calendar year.

Q-6: In what circumstances may participants revoke existing elections and make new elections under a cafeteria plan?

A-6: (a) *In general.* A plan is not a cafeteria plan unless the plan requires that participants make elections among the benefits offered under the plan. In general, an election will not be deemed to have been made if, after a participant has elected and begun to receive a benefit under the plan, the participant is permitted to revoke the election during the period of coverage under the plan, even if the revocation relates only to the remaining portion of the coverage period with respect to the benefit and even if the revocation is in response to a change in the tax treatment of such benefit. However, to the extent permitted under §1.125-4, the terms of a cafeteria plan may permit a participant to revoke an existing election and to make a new election with respect to the remaining portion of the period of coverage.

(b) *Cessation of required contributions.* A cafeteria plan may provide that a benefit will cease to be provided to an employee if the employee fails to make the required premium payments with respect to the benefit (e.g., employee ceases to make premium payments for health plan coverage after a separation from service). However, in such case, the plan must prohibit the employee from making a new benefit election for the remaining portion of the period of coverage.

Q-7: How do the rules governing the tax-favored treatment of employer-provided benefits apply to plans that are flexible spending arrangements?

A-7: (a) *In general.* Health plans that are flexible spending arrangements as defined in paragraph (c) of this Q&A-7 (health FSAs) must conform to the generally applicable rules under sections 105 and 106 in order for the coverage and reimbursements under such plans to qualify for tax-favored treatment under such sections. Thus, health FSAs must qualify as accident or health plans. This means that, in general, while the health coverage under the FSA need not be provided through a commercial insurance contract, health FSAs must exhibit the risk-shifting and risk-distribution characteristics of insurance. Similarly, reimbursements under health FSAs must be paid specifically to reimburse the participant for medical expenses incurred previously during the period of coverage. Furthermore, a health FSA cannot operate under a cafeteria plan in a manner that enables participants to receive coverage only for periods for which the participants expect to incur medical expenses if such periods constitute less than a plan year. A reimbursement is not paid specifically to reimburse the participant for medical expenses if the participant is entitled to these amounts, in the form of cash or any other taxable or nontaxable benefit (including health coverage for an additional period), without regard to whether or not the employee incurs medical expenses during the period of coverage. A health FSA will not qualify for tax-favored treatment under sections 105 and 106 of the Code if the effect of the reimbursement arrangement eliminates all, or substantially all, risk of loss to the employer maintaining the plan or other insurer. These rules apply with respect to a health plan without regard to whether the plan is provided through a cafeteria plan. See Q&A-17 of §1.125-1.

(b) *Special requirements—(1) In general.* A health FSA must satisfy the requirements set forth in this paragraph (b) in order for the employer-provided health coverage provided through the health FSA to qualify for

the exclusion from income under section 106 and for the reimbursements and other benefits pursuant to the health FSA coverage to qualify for the exclusion from income under section 105.

(2) *Uniform coverage throughout coverage period.* The maximum amount of reimbursement under a health FSA must be available at all times during the period of coverage (properly reduced as of any particular time for prior reimbursements for the same period of coverage). Thus, the maximum amount of reimbursement at any particular time during the period of coverage cannot relate to the extent to which the participant has paid the required premiums for coverage under the health FSA for the coverage period. Similarly, the payment schedule for the required premiums for coverage under a health FSA may not be based on the rate or amount of covered claims incurred during the coverage period. Reimbursement will be deemed to be available at all times if it is paid at least monthly or when the total amount of the claims to be submitted is at least a specified, reasonable minimum amount (e.g., \$50). If the employee revokes existing elections, the employer must reimburse the employee for any amount previously paid for coverage or benefits relating to the period after the date of the employee's separation from service regardless of the employee's claims or reimbursements as of such date. The following examples illustrate the rules of this paragraph (b)(2):

Example 1. Assume that an employee elects coverage under a health FSA providing coverage of up to \$300 in medical expenses and the annual premium for a calendar year of coverage is \$300. Assume also that the employee is permitted to pay the \$300 premium through salary reduction of \$25 per month throughout the coverage period. The employee must be eligible to receive the maximum amount of reimbursement of \$300 at all times throughout the coverage period (reduced by prior reimbursements). Thus, if the employee incurs \$250 of medical expenses in January, the full \$250 must be available for reimbursement even though the employee has made only one premium payment. If the employee incurs another \$50 in health expenses in February, the remaining \$50 of the \$300 maximum must be available for reimbursement. The employer or plan may not provide for an acceleration of the required premium payments based on the employee's incurred claims and reimbursements.

Example 2. Assume that an employee elects coverage under a health FSA with a maximum reimbursement limit of \$500 for a calendar year of coverage and is required to pay the \$450 premium for such coverage in two equal \$225 installments, one at the beginning of the period of coverage and the second installment by the beginning of the sixth month of coverage. Assume further that the employee incurs a \$400 medical expense in February and the FSA makes a \$400 reimbursement to the employee in March. The employee does not incur any additional medical expenses before the end of June, at which time the employee separates from service. If the employee fails to make the second premium installment, the employee's coverage under the FSA may be terminated as of the end of June so that medical expenses incurred after June are not covered. If the employee pays the second premium installment, the employee's coverage under the FSA must continue, so that additional medical expenses (up to the remaining \$100) incurred before the end of December are covered.

(3) *Twelve-month period of coverage.* The period of coverage under a health FSA must be 12 months or, in the case of a short first plan year or a short plan year of a cafeteria plan where the plan year is being changed, the entire short plan year. Election changes to increase or decrease the level of coverage under a health FSA during the 12-month period of coverage are not permitted with respect to health FSAs. However, a cafeteria plan may permit participants to make health FSA election changes for the remaining portion of the 12-month period of coverage on account of and consistent with certain family status changes. See Q&A-6 of this section. In addition, a cafeteria plan may provide that the period of coverage under a health FSA terminates if the employee ceases to make required premium payments; however, such employee may not be permitted to make a new health FSA benefit election for the remaining portion of the original coverage period. Also, a cafeteria plan may permit an employee who separates from the service of the employer during a period of coverage to revoke existing benefit elections and terminate receipt of benefits, including coverage under the health FSA. For the application of the health care continuation rules of section 4980B of the Code to health FSAs, see the regulations under section 4980B or its predecessor section 162(k) of the Code. The requirements of this paragraph (b)(3) are illustrated by the following example:

Example. Assume that an employee has elected a \$300 calendar year health FSA, with monthly premium payments of \$25 during the 12-month period of coverage. Such employee separates from service for the employer at the end of June and ceases to make additional premium payments. The cafeteria plan may provide that the FSA's period of coverage does not extend beyond June if the employee does not continue to make the required premium payments. However, if the employee makes the total premium payment for the 12-month period of coverage, the cafeteria plan may not terminate the FSA's period of coverage merely because the employee separated from service before the end of the coverage period.

(4) *Prohibited reimbursement.* A health FSA can only reimburse medical expenses as defined in section 213. Thus, for example, a health FSA cannot reimburse dependent care expenses. In addition, a health FSA may not treat participants' premium payments for other health coverage as reimbursable expenses. Thus, for example, a health FSA may not reimburse participants for premiums paid for other health plan coverage, including premiums paid for health coverage under a plan maintained by the employer of the employee's spouse or dependent. (See also Q&A-5 of this section with respect to whether the reimbursement of other premiums constitutes impermissible deferred compensation.) This paragraph (b)(4) does not prevent premiums for current health plan coverage (including coverage under a health FSA) from being paid on a salary reduction basis through the ordinary operation of the cafeteria plan.

(5) *Claims substantiation.* A health FSA may reimburse a medical expense only if the participant provides a written statement from an independent third party stating that the medical expense has been incurred and the amount of such expense and the participant provides a written statement that the medical expense has not been reimbursed or is not reimbursable under, any other health plan coverage. Thus, for example, as with any other flexible spending arrangement, a health FSA cannot make advance reimbursements of future or projected expenses. In determining whether, under all the facts and circumstances, employees are being reimbursed for inadequately substantiated claims, special scrutiny will be given to other arrangements such as employer-to-employee loans that are related to the employee premium payments or actual or projected employee claims.

(6) *Claims incurred.* Medical expenses reimbursed under a health FSA must be incurred during the participant's period of coverage under the FSA. Expenses are treated as having been incurred when the participant is provided with the medical care that gives rise to the medical expenses, and not when the participant is formally billed or charged for, or pays for the medical care. Also, expenses are not treated as incurred during a period of FSA coverage if such expenses are incurred before the later of the date the health FSA is first in existence or the participant first becomes enrolled under the health FSA.

(7) *FSA experience gains.* If a health FSA has an experience gain with respect to a year of coverage, the excess of the premiums paid (e.g., employer contributions, including salary reduction contributions and after-tax employee contributions) and income (if any) of the FSA over the FSA's total claims reimbursements and reasonable administrative costs for the year may be used to reduce required premiums for the following year or may be returned to the premium payers (the participants for premiums paid by salary reduction or employee contributions) as dividends or premium refunds. Such experience gains must be allocated among premium payers on a reasonable and uniform basis. It is permissible to allocate such amounts based on the different coverage levels under the FSA received by the premium payers. However, in no case may the experience gains be allocated among premium payers based (directly or indirectly) on their individual claims experience. The requirements of this paragraph (b)(7) are illustrated in the following example:

Example. Assume that an employer maintains a cafeteria plan under which its 1,200 employees may elect one of several different annual coverage levels under a health FSA in \$100 increments from \$500 to \$2,000. For a plan year, 1,000 employees elect levels of coverage under the health FSA. For such year, the FSA has an experience gain of \$5,000 (i.e., premium payments for the year exceed reimbursed claims plus administrative costs by \$5,000). The \$5,000 may be allocated to all premium payers for the year, as a premium refund, on a per capita basis weighted to reflect the participants' elected levels of coverage. Alternatively, the \$5,000 may be used to reduce the required premiums under the health FSA for all eligible employees for the next plan year (e.g., a \$500 health FSA for the next year might be priced at \$480) or to reimburse claims incurred above the elective limit in such year as long as such reimbursements are made in a nondiscriminatory manner.

(8) *Dependent care assistance.* Analogous rules to this paragraph (b), with the exception of paragraph (b)(2) relating to uniform coverage throughout the coverage period, are applicable to dependent care assistance provided under section 129. See Q&A-18 of §1.125-1.

(c) *Definition of flexible spending arrangement.* A flexible spending arrangement (FSA) generally is a benefit program that provides employees with coverage under which specified, incurred expenses may be reimbursed (subject to reimbursement maximums and any other reasonable conditions) and under which the maximum amount of reimbursement that is reasonably available to a participant for a period of coverage is not substantially in excess of the total premium (including both employee-paid and employer-paid portions of the premium) for such participant's coverage. A maximum amount of reimbursement is not substantially in excess of the total premium if such maximum amount is less than 500 percent of the premium. A single FSA may provide participants with different levels of coverage and maximum amounts of reimbursement. However, for purposes of section 89, each different level of coverage under a FSA is a separate plan.

(d) *Effective date.* This Q&A-7 is effective for plan years beginning after December 31, 1989.

(e) *Authority to issue additional requirements.* The Commissioner, in revenue rulings, notices and other publications of general applicability, may make any modification to, or issue such additional requirements for the application of, the rules contained in this Q&A-7 as may be necessary to insure proper compliance with the intent of such rules.

(f) *Example.* The provisions of paragraph (c) of this Q&A-7 are illustrated by the following example:

Example 1. Assume that an employer with 1,000 employees maintains a cafeteria plan under which the employees may elect among several benefit options, including insured health plans and HMOs. The plan provides that the required premiums or contributions for the benefits are to be made by salary reduction. Even though the plan may characterize employees' premium payments and other contributions as flexible spending contributions or credits, the operation of a cafeteria plan to permit employees' contributions to be made on a salary reduction basis does not, standing alone, cause the plan (or any benefit thereunder) to be treated as a flexible spending arrangement.

Example 2. Assume that an employer with 1,000 employees maintains a cafeteria plan under which the employees may elect, among other benefits, a level of coverage under an arrangement that will reimburse medical expenses incurred during a year up to the specified amount elected by the employee. The maximum amount of reimbursement that can be deducted for a year is \$5,000. Each employee's premium for such coverage is equal to the maximum reimbursement amount selected by the employee. Such an arrangement is a health FSA. [Reg. §1.125-2.]

TEMP-REG, 2002FED ¶7323, §1.125-2T, Question and answer relating to the benefits that may be offered under a cafeteria plan (Temporary).

§1.125-2T Question and answer relating to the benefits that may be offered under a cafeteria plan (Temporary).

Q-1: What benefits may be offered to participants under a cafeteria plan?

A-1: (a) Generally, for cafeteria plan years beginning on or after January 1, 1985, a cafeteria plan is a written plan under which participants may choose among two or more benefits consisting of cash and certain other permissible benefits. In general, benefits that are excludable from the gross income of an employee under a specific section of the Internal Revenue Code may be offered under a cafeteria plan. However, scholarships and fellowships under section 117, vanpooling under section 124, educational assistance under section 127 and certain fringe benefits under section 132 may not be offered under a cafeteria plan. In addition, meals and lodging under section 119, because they are furnished for the convenience of the employer and thus are not elective in lieu

of other benefits or compensation provided by the employer, may not be offered under a cafeteria plan. Thus, a cafeteria plan may offer coverage under a group-term life insurance plan of up to \$50,000 (section 79), coverage under an accident or health plan (sections 105 and 106), coverage under a qualified group legal services plan (section 120), coverage under a dependent care assistance program (section 129), and participation in a qualified cash or deferred arrangement that is part of a profit-sharing or stock bonus plan (section 401(k)). In addition, a cafeteria plan may offer group-term life insurance coverage which is includible in gross income only because it is in excess of \$50,000 or is on the lives of the participant's spouse and/or children. In addition, a cafeteria plan may offer participants the opportunity to purchase, with after-tax employee contributions, coverage under a group-term life insurance plan (section 79), coverage under an accident or health plan (section 105(e)), coverage under a qualified group legal services plan (section 120), or coverage under a dependent care assistance program (section 129). Finally, a cafeteria plan may offer paid vacation days if the plan precludes any participant from using, or receiving cash for, in a subsequent plan year, any of such paid vacation days remaining unused as of the end of the plan year. For purposes of the preceding sentence, elective vacation days provided under a cafeteria plan are not considered to be used until all nonelective paid vacation days have been used.

(b) Note that benefits that may be offered under a cafeteria plan may or may not be taxable depending upon whether such benefits qualify for an exclusion from gross income. However, a cafeteria plan may not offer a benefit that is taxable because such benefit fails to satisfy any applicable eligibility, coverage, or nondiscrimination requirement. Similarly, a plan may not offer a benefit for purchase with after-tax employee contributions if such benefit would fail to satisfy any eligibility, coverage, or nondiscrimination requirement that would apply if such benefit were designed to be provided on a nontaxable basis with employer contributions. Also, note that section 125(d)(2) provides that a cafeteria plan may not offer a benefit that defers the receipt of compensation (other than the opportunity to make elective contributions under a qualified cash or deferred arrangement) and may not operate in a manner that enables participants to defer the receipt of compensation. [Temporary Reg. §1.125-2T.]

.10 Historical Comment: Adopted 1/29/86 by T.D. 8073 . [Reg. §1.125-2T does not reflect P.L. 99-514 (1986), P.L. 100-647 (1988), P.L. 101-508 (1990) or P.L. 104-191 (1996). See ¶7320.0129 et seq., ¶7324.01 and ¶7324.021 .]

FINAL-REG, 2002FED ¶7323B, §1.125-3, Effect of the Family and Medical Leave Act (FMLA) on the operation of cafeteria plans.—

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161
(Cite as: 2008 WL 4488995 (E.D.N.Y.))

C

United States District Court,
E.D. New York.
UNITED STATES of America
v.
Steven COREN, Defendant.
No. 07-CR-265 (ENV).

Aug. 29, 2008.

West KeySummary
Labor and Employment 231H ↪ 3281

231H Labor and Employment

231HXX Offenses and Penalties

231HXX(B) Prosecutions

231Hk3281 k. Indictment, Information, or Complaint. Most Cited Cases

A defendant's motion to dismiss an indictment that charged him with various crimes relating to federal minimum wage laws was denied when the facts alleged in the indictment were sufficient. Federal law requires employers engaged in certain contracts with the federal government to pay their employees a certain minimum wage. The indictment alleged facts that demonstrated that the defendant devised a trust account with the specific intent to help contractors shirk their prevailing wage obligations and to divert money that should have been spent on benefits for prevailing wage workers back into their own pockets. 40 U.S.C.A. § 3142.

Richard T. Faughnan, Sarah Mary Coyne, United States Attorneys Office, Eastern District of New York, Brooklyn, NY, for United States of America.

Marc Lee Mukasey, Bracewell & Giuliani LLP, Lawrence H. Schoenbach, New York, NY, for Defendant.

MEMORANDUM AND ORDER

VITALIANO, District Judge.

*1 Defendant Steven Coren moves to dismiss crimi-

nal charges brought against him in a 17 count indictment filed on April 4, 2007. For purposes of the motion the factual allegations are deemed true and, following extensive briefing including by *amici*, the motion is denied.

Background

The indictment charges, in substance, that Coren, an attorney, devised for clients schemes to defraud various government entities relating to construction contracts subject to the Davis-Bacon Act, Title 40, U.S.C. § 3142 ("Davis-Bacon") or New York Labor Law Section 220, et seq. ("Section 220" or "Little Davis-Bacon"), by creating the false appearance that laborers working for the contractors were being paid the required prevailing wage. Specifically, counts one through ten charge Coren with mail fraud, in violation of 18 U.S.C. §§ 1341 and 2; counts 11 through 13 charge Coren with wire fraud, in violation of 18 U.S.C. §§ 1342 and 2; and counts 14 through 16 charge Coren with money laundering and money laundering conspiracy, in violation of 18 U.S.C. §§ 1956(1)(3)(B) and 1956(h), respectively. Count 17 charges Coren with obstruction of justice in violation of 18 U.S.C. § 1512(c)(1) through the altering or concealing of records with the intent to impair their integrity and availability for use in an official proceeding.

Applicable Statutes

Davis-Bacon requires that contracts in excess of \$2,000 to which the United States is a party for the construction, alteration, or repair of public buildings or public works contain a provision "stating the minimum wages to be paid various classes of laborers and mechanics." 40 U.S.C. § 3142(a). The minimum wages to be paid are the wages that the Secretary of Labor determines to be "prevailing" for laborers and mechanics employed on similar projects in the same geographical area in which the work is to be performed (the "prevailing wage"). 40 U.S.C. § 3142(b). As set by the statute, the prevailing wage has two components, both of which are computed on an hourly basis: a basic rate of pay and a fringe benefit amount.^{FNI} A contractor may discharge its prevailing wage fringe benefit obligations by either: (1) pay-

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161

(Cite as: 2008 WL 4488995 (E.D.N.Y.))

ing in cash; (2) making contributions to a trustee or to a third person pursuant to a fund, plan, or program referred to in 42 U.S.C. § 3141(2)(B)(i); (3) assuming an enforceable commitment to bear the costs of a plan or program referred to in 42 U.S.C. § 3141(2)(B)(ii); or (4) by a combination thereof. 40 U.S.C. § 3142(d).

FN1. Specifically, Davis-Bacon provides as follows:

Wages, scale of wages, wage rates, minimum wages, and prevailing wages.-The terms “wages”, “scale of wages”, “wage rates”, “minimum wages”, and “prevailing wages” include-

(A) the basic hourly rate of pay; and

(B) for medical or hospital care, pensions on retirement or death, compensation for injuries or illness resulting from occupational activity, or insurance to provide any of the forgoing, for unemployment benefits, life insurance, disability and sickness insurance, or accident insurance, for vacation and holiday pay, for defraying the costs of apprenticeship or other similar programs, or for other bona fide fringe benefits, but only where the contractor or subcontractor is not required by other federal, state, or local law to provide any of those benefits, the amount of-

(i) the rate of contribution irrevocably made by a contractor or subcontractor to a trustee or to a third person under a fund, plan, or program; and

(ii) the rate of costs to the contractor or subcontractor that may be reasonably anticipated in providing benefits to laborers and mechanics pursuant to an enforceable commitment to carry out a financially responsible plan or program which was communicated in writing to the laborers and mechanics affected.

40 U.S.C. § 3141(2).

New York's Little Davis-Bacon Act contains essentially the same provisions as the federal prevailing wage law. Pursuant to this statute, each contract, to which the state, a locality, a public benefit corporation, or a commission appointed by law is a party, for the construction, alteration, or repair of a public works project must contain a provision requiring that laborers, workmen and mechanics be paid not less than the prevailing wage, to be determined by either the New York State Department of Labor, or the New York City Comptroller if the work is performed for agencies of the City of New York. As with Davis-Bacon, under Section 220, the prevailing wage consists both of a basic hourly rate and supplemental benefit rate. “Supplements”, as defined by the statute, mean “all remunerations for employment paid in any medium other than cash ... or any payments which are not ‘wages’ ... including, but not limited to, health, welfare, non-occupational disability, retirement, vacation benefits, holiday pay, life insurance, and apprenticeship training.” Section 220(5).^{FN2}

FN2. Because Davis-Bacon and Section 220 contain virtually identical requirements, the Court will hereinafter use “prevailing wage” to refer to the requirements of both statutes. The Court will likewise use “fringe benefit wage” to refer both to fringe benefits defined by Davis-Bacon and supplements defined by Section 220.

*2 Davis-Bacon and Little Davis-Bacon each requires contractors, on a regular basis, to submit a transcript of their payroll to a public agency and to certify under the penalties of perjury that they complied with the prevailing wage requirements. *See* 29 C.F.R. § 5.5(a)(3); *Hopkins v. United States Dep't of Hous. & Urban Dev.*, 929 F.2d 81, 86 (2d Cir.1991) (“To demonstrate compliance with wage standards, federal contractors are required to submit weekly certified statements with respect to the wages paid each affected employee.”); Section 220(3-a)(a)(iii). Credit is given for compliance when the contractor has met the obligations as to both the hourly wage and the fringe benefit wage.

Relevant Facts

Coren, during the relevant time, practiced out of the Manhattan offices of his law firm, Coren & Associates, P.C. As part of his practice, Coren advised sev-

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161

(Cite as: 2008 WL 4488995 (E.D.N.Y.))

eral contractor clients. In connection with this work, in 1993, Coren established the Contractor's Benefit Trust (the "CBT"), an entity formed under the dual authority of ERISA and the IRS Code. As stated in its Declaration of Trust, the CBT was created "to provide benefits under New York State Labor Law Section 220 (and other similar state laws in other states), the Davis-Bacon Act, or any other state or federal rule requiring the payment of prevailing supplemental benefits which include pension annuity, vacation, health and welfare, or like benefits." As devised by Coren, client-contractors who participated in the CBT would make prevailing wage fringe benefit payments to the trust as irrevocable contributions to a trustee or a third person under a fund, plan, or program. The CBT then served as a "benefits bank", funding various types of employee welfare benefits, including health, vacation, and the like to certain eligible employees. Companies utilizing the CBT signed a Participation Agreement, by which the employer designated the specific benefits plan(s) it wanted to provide its employees. Coren was the trustee of the CBT.

Contributions to the CBT were expressly limited to those funds necessary to cover fringe benefits required to be paid to workers under the provisions of a state and/or federal prevailing wage law. Further, absent written permission from the trustee (Coren), contributions were permitted only if the employer actually received credit for the contribution in satisfaction of its obligation to provide such prevailing wage benefits. Consequently, the monies held in the CBT consisted solely of contributions that Coren's client-contractors had certified to state and/or federal agencies satisfied their obligation to pay prevailing wage fringe benefits owed by law to prevailing wage employees.

As charged in the indictment, Coren knew, and, in fact, intended, that employer contributions to the CBT would not be used exclusively to provide fringe benefits to the prevailing wage employees on whose behalf credit had been claimed by his client-contractors. Rather, the funds in the CBT were used for the purchase of welfare benefits for company employees without regard to the type of work performed by that employee. In some instances, the benefits paid by the CBT inured solely, or, at least, mostly, to the benefit of the owners and operators of the companies themselves. Coren, it is therefore alleged, advised, counseled and assisted his client-contractors in

using the CBT to claim fraudulently to state and federal agencies that they were in full compliance with their prevailing wage obligations, even though a significant portion of the funds contributed to the CBT were not used to provide fringe benefits for the workers on whose behalf the contribution had been made and prevailing wage credit received. Put simply, the indictment's essential criminal theme is that Coren assisted these owners and operators in diverting funds deposited on behalf of prevailing wage workers, and reported to state and federal agencies as satisfying prevailing wage obligations, back into their own pockets. Correspondingly, under Coren's alleged scheme, employees working on government projects received wages below the prevailing wage, despite the employer's contrary sworn certification.

*3 The fraudulent schemes allegedly contrived by Coren were described with some detail in the indictment:

Fraudulent Scheme 1: In 2000, Coren established a CBT account for two door manufacturing and installation companies, known as Corporation-1 and Corporation-2, both of which were owned and operated by Cooperating Witness 1 (CW-1) and Cooperating Witness 2 (CW-2). These corporations performed work primarily on publicly funded projects subject to prevailing wage obligations. Coren advised and counseled CW-1 and CW-2 to deposit funds into the CBT that they would claim as fringe benefit contributions in satisfaction of their prevailing wage obligations. Coren then further advised CW-1 and CW-2 to use those deposits to purchase benefits, such as health insurance, for nonprevailing wage employees of the corporations on whose behalf the contributions to the CBT had *not* been made. The indictment further charges that Coren advised, counseled and assisted CW-1 and CW-2 in setting up a vacation trust that maintained eligibility requirements which essentially precluded all employees from receiving any vacation and holiday benefit, except for CW-1 and CW-2, who were themselves nonprevailing wage employees.

Fraudulent Scheme 2: On or about August 2003, Coren established a CBT account for Corporation 3. Corporation 3 was partly owned by Cooperating Witness 3 (CW-3). Cooperating Witness 4 (CW-4) was employed by CW-3 as the office manager. Coren allegedly advised, counseled and assisted CW-3 and CW-4 in establishing a CBT account into which Cor-

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161

(Cite as: 2008 WL 4488995 (E.D.N.Y.))

poration-3 would deposit funds claimed as fringe benefit contributions in satisfaction of prevailing wage obligations. As with the previous scheme, the indictment claims Coren advised CW-3 and CW-4 to use those CBT deposits to purchase benefits for non-prevailing wage employees on whose behalf fringe benefit contributions had not been made. Coren also advised and counseled CW-3 and CW-4, it is charged, to deposit funds into the CBT account for one specified group of prevailing wage workers and then transfer some or all of the funds in that account to various labor union benefit funds on behalf of a separate group of prevailing wage workers, for whom Corporation 3 also claimed to have satisfied its fringe benefit obligations. Thus, the indictment charges, on the advice and with the assistance of Coren, Corporation-3 took credit for having paid the fringe benefit portion of the prevailing wage for two groups of workers, while actually depositing money on behalf of only one group.

As one would expect, the obstruction of justice count relates to the investigation which precipitated the principal counts of the indictment. To that end, count 17 references the work of a grand jury in the Eastern District of New York, duly empanelled in November 2005, that was investigating one of the fraudulent schemes charged in this indictment. Thereafter, on or about January 12, 2006, Coren was informed by a cooperating witness that his company was under investigation by a law enforcement agency and that law enforcement officials had obtained certified payrolls submitted by the corporation for work it performed as a subcontractor on various state and federal projects. Coren, in response, allegedly advised the owners and operators of the company, with whom he had previously dealt, to conceal and destroy records, documents and other objects relating to the transfer of CBT funds.

Rule of Decision

*4 Federal Rule of Criminal Procedure 12(b)(2) permits a criminal defendant to raise by pretrial motion "any defense, objection, or request that the court can determine without a trial of the general issue." A court faced with a motion to dismiss must ask, first, whether the indictment states an offense, and second, whether the indictment is sufficiently specific to provide notice and allow the defendant to plead double jeopardy in a subsequent case. See United States v.

Sierra-Garcia, 760 F.Supp. 252, 258 (E.D.N.Y.1991). Allegations of fact in the indictment must be accepted as true and contrary assertions of fact by the defendant will not be considered. United States v. Goldberg, 756 F.2d 949, 950 (2d Cir.1985).

Discussion

Coren primarily advances three arguments in support of his motion to dismiss. First, that the indictment does not charge a crime because Coren's client-contractors fully complied with Davis-Bacon and Section 220 by claiming credit for funds deposited into the CBT. Second, that, to the extent Davis-Bacon and Little Davis-Bacon require anything more than a contribution to a fund, such as the CBT, the statute fails to provide adequate notice of the prohibited conduct. Finally, that, even assuming, *arguendo*, the client-contractors were in violation of applicable prevailing wage laws, Coren cannot be criminally liable because he did not advise his clients as to the amount of credit they could properly claim.

ERISA and Prevailing Wage Law

The heart of Coren's motion to dismiss focuses on the intersection of ERISA and the prevailing wage laws. According to Coren, because ERISA controls the operation of a benefit trust, such as the CBT, prevailing wage laws can require only that employers who are subject to prevailing wage requirements contribute a defined amount to an ERISA-qualified benefits trust, but cannot, in any way, dictate how those funds are then distributed. Coren thus contends that an employer can properly claim prevailing wage credit for contributions to a trust in the name of prevailing wage workers, regardless of whether and how those contributions relate to benefits ultimately provided (or not provided) to those workers. Furthermore, Coren points out, ERISA precludes discrimination by employers among employees who are "qualified" to receive benefits-as defined by a plan or program-and that, under ERISA, employees have no ownership interest or specific right to any asset in such a fund. Coren also notes that ERISA preempts state law, such that state prevailing wage laws cannot (1) prescribe either the type and/or the amount of an employer's contribution to a plan, rules or (2) promulgate regulations under which a plan operates, or (3) dictate the nature or amount of benefits provided under the plan. For these reasons, Coren argues that contributing to a

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161

(Cite as: 2008 WL 4488995 (E.D.N.Y.))

trust alone must satisfy prevailing wage obligations, even if those contributions do not relate, in any way, to benefits ultimately provided to prevailing wage workers:

*5 For government prevailing wage reporting purposes, if the benefits wages are contributed to a proper ERISA trust, the contractor has met his obligation under Davis-Bacon. Once the benefits have been deposited, the specific rules governing the ERISA plan take effect and define acceptable uses of the funds such as non-discriminatory benefit payments on behalf of plan participants pursuant to the employer's plan.

(Def's Br. at 10.) Since, as it is alleged in the indictment, Coren's client-contractors did contribute money to a qualified ERISA trust, and both Coren and his clients were in full compliance with ERISA, Coren contends that the indictment fails to state a crime.

The government conceded at oral argument there is no allegation that the CBT, and Coren as trustee of the CBT, failed to comply with ERISA. But, it is more of a demurrer than a concession for the government argues that compliance with ERISA is irrelevant to the question of whether Coren and his client-contractors criminally violated prevailing wage laws. According to the government, prevailing wage laws require that there be a reasonable relationship between contributions to a trust on behalf of prevailing wage workers and benefits actually received by those workers in order for an employer to properly claim credit. Whether the employer complies with ERISA in the operation of the trust is irrelevant, the government says, to the question of whether the employer properly claimed credit under prevailing wage laws. Coren argues that the government's position is untenable, because ERISA controls plan benefit payments to workers, and, under ERISA, an employee has no ownership interest or other specific rights; "no member of a defined benefit plan under ERISA has a claim to any particular asset that composes a part of the plan's general asset pool." (Def's Br. at 15 (citing *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 440, 119 S.Ct. 755, 142 L.Ed.2d 881 (1999).))

Coren's argument, though provocative, is fatally flawed. First and foremost, nothing in the prevailing wage laws requires the payment of supplemental

benefits through an ERISA-qualified trust. The laws simply require that they be paid. They could, of course, always have been paid in cash. Therefore, whatever an employer's obligations are under Davis-Bacon, they are not discharged *solely* because dollars *claimed* to satisfy payment of a prevailing supplement wage obligation are in fact contributed to an ERISA qualified-fund, plan or program; nor is the government precluded from examining who the actual beneficiaries of the CBT were in order to determine compliance with prevailing wage laws. ERISA and Davis-Bacon need not work at cross purposes, and when an employer chooses to utilize an ERISA-qualified trust to satisfy its Davis-Bacon obligation, compliance must be had with both.

Moreover, the relationship between prevailing wage laws and ERISA is not one of first impression in this Circuit. In *HMI Mech. Sys., Inc. v. McGowan*, 266 F.3d 142 (2d Cir.2001), the court of appeals addressed the intersection of ERISA and Section 220. In that case, an employer challenged New York's labor regulations, which determined a contractor's compliance with Section 220 by using, among other things, an annualization formula.^{FN3} *Id.* at 145. To enforce Section 220, the state required that HMI, the plaintiff-employer, submit internal allocations of benefits to determine the adequacy of benefits distributed under its plan. *Id.* at 146. In particular, the state had subpoenaed documents and records "which look[ed] to the effect of pooling plan contributions to benefit not only public workers but also private workers or public workers on private projects." *Id.* at 150. "[T]he subpoenas sought to uncover whether employers were diminishing the prevailing wage protections for public projects by spreading the benefits over hours worked on private projects." *Id.*

^{FN3}. Under the principle of annualization, an employer calculates the hourly cash equivalent fringe benefits that contractors paid by dividing that actual cash value of the employer's contribution by the total number of hours employees worked annually on both public and private jobs. See *infra* note 6.

*6 The plaintiff in that case had chosen to satisfy its fringe benefit obligations by contributing to a pooled ERISA trust^{FN4}, similar to the CBT. There, as here, the plaintiff claimed that the state's inquiry under

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161

(Cite as: 2008 WL 4488995 (E.D.N.Y.))

Section 220 improperly focused on the internal allocation and adequacy of benefits provided by the trust, an examination that plaintiff argued was preempted by ERISA. The Second Circuit rejected this argument, holding that the state's method of enforcement only indirectly affected ERISA plans. *Id.* at 151. Specifically, the Circuit held that the state was not mandating a particular structure for ERISA plans, did not require plans to exclude participants who performed work on private projects, and did not mandate a particular method of administering the ERISA plan. *Id.* To the contrary, employers remained free to satisfy their prevailing wage obligations through any combination of contributions to ERISA plans, contributions to non-ERISA plans, or cash payments. *Id.* In fact, even noting that New York's enforcement methods eliminated incentives for employers to pool supplemental contributions among public and private workers, the court held that "ERISA does not preempt a law that uses economic incentives in this way. *Id.* (citing California Div. of Labor Standards Enforcement v. Dillingham Constr., N.A., Inc., 519 U.S. 316, 32, 117 S.Ct. 832, ---, 136 L.Ed.2d 791, --- (1997)). See also Burgio & Campofelice, Inc. v. New York State Dep't of Labor, 107 F.3d 1000, 1009 (2d Cir.1997) (holding, in relation to Section 220, "[w]here a legal requirement may be easily satisfied through means unconnected to ERISA plans, and only relates to ERISA plans at the election of an employer, it affects employee benefit plans in too tenuous, remote, or peripheral a manner to warrant a finding that the law 'relates to' the plan"); Minnesota Chapter of Associated Builders & Contractors, Inc. v. Minnesota Dep't of Labor & Indus., 47 F.3d 975 (8th Cir.1995) (prevailing wage law not preempted by ERISA where it did not require employer to provide any level of benefit and only affected benefit plans to the extent that the employer chose to include benefits as part of the wage); Keystone Chapter, Associated Builders & Contractors, Inc. v. Foley, 37 F.3d 945 (3d Cir.1994) (ERISA did not preempt state prevailing wage law where the law did not single out ERISA plans for special treatment or even refer to such plans, and in the absence of ERISA, the wage law could be meaningfully applied).

FN4. A pooled trust, the court explained, is one which provides benefits to prevailing wage workers both during periods when they work on prevailing wage jobs and during periods when they work on private jobs, as well as to nonprevailing wage workers.

That is the case here as well. There is no essential conflict between ERISA and the government's enforcement of the prevailing wage laws. The indictment does not, as Coren contends, suggest that the structure of the CBT is illegal, or that, standing alone, the use of a trust, like the CBT, to pay benefits to nonprevailing wage workers violates prevailing wage laws. Rather, the indictment charges that, on the advice, counsel and with the assistance of Coren, Coren's client-contractors defrauded government agencies by falsely claiming credit for paying their public workers the prevailing wage for work performed on public contracts. The CBT is only relevant to the extent that it was developed by Coren as part of the alleged scheme to defraud those agencies into giving prevailing wage *credit*, and thus awarding construction contracts, to his clients, who would fail to pay the prevailing wage. Had Coren's contractor-clients used the CBT in the manner alleged as a pooled trust, *i.e.*, accepting only contributions from prevailing wage workers while providing benefits to nonprevailing wage workers and prevailing wage workers alike, *but* adjusted the amount of prevailing wage credit they claimed accordingly, there would be no fraud, and, consequently, no crime. It is, however, the contractors' alleged use of the CBT, on the advice and counsel of Coren, to give the appearance to government agencies that the employers were paying prevailing wages, while instead effectively using the money to pay other expenses, such as benefits for nonprevailing wage workers, that makes out the crimes charged. Stated differently, the mediacy of an ERISA-qualified trust to accomplish this illegal objective and full compliance with ERISA provide no safe harbor. See HMI, 266 F.3d at 151.

*7 Indeed, Coren himself acknowledged the proper interplay of ERISA and the prevailing wage laws in his reply memorandum of law at pages 4-5:

[The government] goes to great pains to argue that ERISA does not pre-empt all state prevailing wage laws. This is true only to the extent that the prevailing wage law does not impact upon the operation or administration of an ERISA plan. State governments are free to determine *how much credit* to give ERISA plan contributions for purposes of their prevailing wage laws without implicating ERISA pre-emption. Similarly, the federal government routinely enforces Davis-Bacon by restricting

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161

(Cite as: 2008 WL 4488995 (E.D.N.Y.))

the amount of credit it permits an employer to take for contributions to a benefit plan. If the contributions or benefits under that plan do not qualify for Davis-Bacon credit, the employer is not entitled to credit, and must comply with Davis-Bacon in some other fashion. This is the only way to reconcile the requirements of Davis-Bacon and ERISA.

Precisely.

Due Process

Coren argues, in the alternative, that the indictment should be dismissed on the ground that, as applied, the statute is unconstitutionally vague. Of course, fundamental principles of constitutional fair warning mandate “that no individual be forced to speculate, at peril of indictment, whether his conduct is prohibited.” Dunn v. United States, 442 U.S. 100, 112, 99 S.Ct. 2190, 60 L.Ed.2d 743 (1979). One manifestation of that principle is the void-for-vagueness doctrine, which “requires that a penal statute define the criminal offense with sufficient definiteness that ordinary people can understand what conduct is prohibited and in a manner that does not encourage arbitrary and discriminatory enforcement.” Kolender v. Lawson, 461 U.S. 352, 357, 103 S.Ct. 1855, 75 L.Ed.2d 903 (1983); see also United States v. Dauray, 215 F.3d 257, 264 (2d Cir.2000) (“Due process requires that a criminal statute ‘give fair warning of the conduct that it makes a crime.’” (quoting Bouie v. City of Columbia, 378 U.S. 347, 350-51, 84 S.Ct. 1697, 12 L.Ed.2d 894 (1964))). “The touchstone inquiry is ‘whether the statute, either standing alone or as construed, made it reasonably clear at the relevant time that the defendant’s conduct was criminal.’” United States v. Velastegui, 199 F.3d 590, 593 (2d Cir.1999) (quoting United States v. Lanier, 520 U.S. 259, 266, 117 S.Ct. 1219, 137 L.Ed.2d 432 (2005)).

The rule of lenity, another manifestation of the principle of due process, “ensures fair warning by so resolving ambiguity in a criminal statute as to apply it only to conduct clearly covered.... [A]lthough clarity at the requisite level may be supplied by judicial gloss on an otherwise uncertain statute, due process bars courts from applying a novel construction of a criminal statute to conduct that neither the statute nor any prior judicial decision has fairly disclosed to be within its scope.” Lanier, 520 U.S. at 266 (internal citations omitted). “Because the meaning of language

is inherently contextual,” however, the Supreme Court has “declined to deem a statute ‘ambiguous’ for purposes of lenity merely because it was possible to articulate a construction more narrow than that urged by the Government.” Moskal v. United States, 498 U.S. 103, 108, 111 S.Ct. 461, 112 L.Ed.2d 449 (1990) (emphasis in original). The rule “applies only when, after consulting traditional canons of statutory construction, we are left with an ambiguous statute.” United States v. Shabani, 513 U.S. 10, 17, 115 S.Ct. 382, 130 L.Ed.2d 225 (1994). Where such an ambiguity does exist, the rule of lenity requires that “a court should resolve [the] ambiguity in favor of the defendant.” United States v. Polizzi, 549 F.Supp.2d 308, 377 (E.D.N.Y.2008).^{FNS} Finally, it is well established that vagueness challenges other than in the First Amendment context “must be examined in light of the facts of the case, on an as-applied basis.” United States v. Whittaker, 999 F.2d 38, 42 (2d Cir.1993) (quotation omitted); see also United States v. Mazurie, 419 U.S. 544, 550, 95 S.Ct. 710, 42 L.Ed.2d 706 (1997).

^{FNS} Despite chatter to the contrary in certain academic circles, reports of the rule’s demise have been greatly exaggerated. See, e.g., United States v. Santos, --- U.S. ---, 128 S.Ct. 2020, 170 L.Ed.2d 912 (2008) (applying rule of lenity to undefined term in federal money laundering statute); see also Note, The New Rule of Lenity, 119 Harv. L.Rev. 2420, 2421 (2006) (though criticized in recent years, rule of lenity neither “defunct” nor “randomly applied”).

*8 Here, Coren does not argue that the mail and wire fraud statutes are themselves unconstitutionally vague. Rather, Coren contends that, as applied to this case, the mail and wire fraud charges incorporate provisions from Davis-Bacon and Little Davis-Bacon which lack the precision of criminal code. Specifically, Coren claims that the prevailing wage statutes’ lack of guidance on the necessary relationship between funds deposited into a trust account, such as the CBT, and benefits paid from the account in order to claim prevailing wage credit, preclude the imposition of criminal liability. The government responds that this is not a case about unintentional misunderstandings regarding the necessary relationship between deposits to and benefits from the CBT. Rather, it notes, Coren is charged with devising a scheme to

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161
(Cite as: 2008 WL 4488995 (E.D.N.Y.))

intentionally falsify credits to state and federal agencies by establishing the CBT and advising his client-contractors to use the CBT to give the appearance of compliance with prevailing wage obligations. Moreover, the government urges that the relevant prevailing wage laws are neither uncertain nor complex, and that no contractor or attorney would miscomprehend that full prevailing wage credits could not be taken knowing that the money owed in supplemental wages would not be used to benefit the workers entitled to them.

This branch of Coren's motion fails as well. The mail and wire fraud statutes, as applied to the facts alleged in the indictment, are not unconstitutionally vague. Specifically, the mail fraud statute requires the government to show that a defendant devised a scheme to defraud the alleged victim of money, and used the mail to execute the scheme. The wire fraud statute requires the same for schemes in which the wire is used. Though Coren is correct that, at least to the Court's knowledge, this is the first criminal case of its kind, but for every kind of crime there is always an inaugural charge. What is critical and dispositive here is the abundance of authority which patently establishes that the conduct alleged in this inaugural charge is prohibited. The relevant prevailing wage laws, the regulations implementing those laws, as well as caselaw all make clear that, in order to take credit for payments to prevailing wage workers, there must be, at a minimum, a reasonable relationship between the credit taken and the benefit received by the prevailing wage workers for whom the credit is taken.

As an initial matter, the texts of Davis-Bacon and Section 220 make plain that contributions to a trust, for which prevailing wage credit is claimed, must be related to a benefit received by the prevailing wage worker for their work on public projects. As we have seen, prevailing supplement wages may be paid to worker beneficiaries in a number of ways, including through an ERISA-qualified trust, but "all supplements due under [the prevailing wage laws] shall be paid to or on behalf of an employee." See Section 220(3)(e) (emphasis added). And, to that end, employers working on prevailing wage projects must submit a statement of compliance, certifying "[t]hat each laborer or mechanic has been paid not less than the applicable wage rates and fringe benefits or cash equivalents for the classification of work performed."

29 C.F.R. 5.5(a)(3) (emphasis added). Beyond quibble, any reasonable reading of the statutes informs an employer that it may only claim prevailing wage credit for contributions to a trust where there is a nexus between the payment made and a benefit to be actually received by the worker or class of workers on whose behalf prevailing wage credit is taken. Cf., Velastegui, 199 F.3d at 593.

*9 Indeed, legislative history and interpretive caselaw further illuminate this requirement. As the Supreme Court has noted, the primary purpose of such prevailing wage laws is to protect construction workers "from substandard earnings by fixing a floor under wages on Government projects." Walsh v. E.A. Schlecht, 429 U.S. 401, 411, 97 S.Ct. 679, 50 L.Ed.2d 641 (1977) (quoting United States v. Birmingham Constr. Co., 347 U.S. 171, 176-77, 74 S.Ct. 438, 98 L.Ed. 594 (1954)); see Beltron Constr. Co. v. McGowan, 260 A.D.2d 870, 871-72, 688 N.Y.S.2d 783,785 (3d Dep't 1999) ("Labor Law § 220 was enacted to ensure that employees on public works projects are paid wages equivalent to the prevailing rate of similarly employed workers in the locality where the contract is to be performed.") see also Chesterfield Assoc. v. New York States Dep't of Labor, 4 N.Y.3d 597, 830 N.E.2d 287, 797 N.Y.S.2d 389 (2005) (holding that prevailing wage laws also serve to level the playing field among contractors and to prevent underbidding). Clearly, it is the intent of Davis-Bacon to "restrict severely the occasions when prevailing wages may be returned to contractors and to prohibit the use of deductions from employee wages to profit or benefit contractors." Int'l Brotherhood of Electrical Workers, Local 357, AFL-CIO v. Brock, 68 F.3d 1194, 1201 (9th Cir.1995). Further, it matters not whether hourly wages or supplement wages are in issue; the fringe benefits provided for in the Act "constitute an integral part" of an employee's wage. S.Rep. No. 963, 88th Cong., 2d Sess. (1964), reprinted in 1964 U.S.Code Cong. & Admin. News 2339, 2340. Moreover, with regard to funded plans, the legislative history elaborates that contributions made in this manner

... must be irrevocable and they must be made pursuant to a fund, plan, or program. While it was not the desire of the committee to impose specific standards relating to the administration of the plans it is expected that the majority of plans of this nature will be those which are administered in accor-

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161

(Cite as: 2008 WL 4488995 (E.D.N.Y.))

dance with the requirements of section 302(c)(5) of the National Labor Relations Act, as amended. Among other things, therefore, the contributions would have to be placed with a trustee or third person who could not later be required to return them to the contractor or subcontractor making the contributions. This will help insure the bona fides of the plan, fund, or program, and protect and preserve the interest of the beneficiaries in them. The phrase "plan, fund, or program" is merely intended to recognize the various types of arrangements commonly used to provide fringe benefits through employer contributions.

Id. at 2343-44. A "bona fide" plan, therefore, must be one where the funds contributed to the trust are being used to cover an employer's expenses related to the wages required to be paid prevailing wage workers. If an employer could make contributions to a fringe benefit plan that were not reasonably related to the benefits actually received by such an employee, the prevailing wage statutes would have no effect: employers would incur no or little cost with respect to these employees and the covered class of employees will not receive the appropriate full "wage". The plain meaning of these words dictates this most uncomplicated understanding.^{FN6}

FN6. Further support for this common sense interpretation can be found in the principle of annualization, utilized both under Davis-Bacon and Section 220. Through annualization, as explained in *HMI*, an employer who contributes to a pooled trust, that is, covering benefits distributed also to nonprevailing wage workers or prevailing wage workers on nonprevailing wage jobs, must calculate the prevailing wage credits available by dividing the actual cash value of the fringe benefit contributions by the number of total hours employees worked annually on both public and private jobs. *HMI*, 166 F.3d at 145. In that way, agencies ensure that prevailing wage workers are not underpaid, because the employer cannot dilute the supplements due to each public work employee by spreading the benefits out to cover both public and private work. *Id.* Wage underpayment is exactly what is alleged here.

*10 Although Coren is correct that the issue of an

employer's satisfaction of its obligations under Davis-Bacon as Coren's clients claimed they did is one of first impression in this Circuit, more than the plain meaning of words should have provided him guidance in advance. In *Miree Construction Corporation v. Dole*, 930 F.2d 1536 (11th Cir.1991), the Eleventh Circuit, reviewing *de novo* a decision of the Wage Appeals Board considered an employer's obligations under Davis-Bacon. There, the Court held, unequivocally, that "an employer may *only* receive Davis-Bacon credit for contributions that are *reasonably related* to the [benefit conferred on the employee]." *Id.* at 1543 (emphasis added). As explained by the *Miree* court: The Davis-Bacon Act "was not enacted to benefit contractors, but rather to protect their employees from substandard earnings.... If an employer could make contributions to a fringe benefit plan that were not reasonably related to the benefits actually received by the employee, the employee would not receive an appropriate 'wage' as contemplated by the Act." *Id.*; see also *Chesterfield 4 N.Y.3d* at 604-05, 797 N.Y.S.2d 389, 830 N.E.2d at 292 ("Because Chesterfield contributed to the profit-sharing plan not only for its employees' public work but also for their private work, however, there was room for shifting costs on paper to overstate its payments on behalf of public hours, which would have bestowed an unfair competitive advantage on Chesterfield and denied its employees the full value of the supplements to which they were entitled. To protect against this potential cost shifting, the Commissioner chose to average Chesterfield's contributions over all work, both public and private, to which pension benefits might be related. This resulted in a proportionate credit to offset Chesterfield's supplement obligations. We cannot say that the Commissioner acted unreasonably or irrationally in taking this approach under the circumstances of this case.")

Further, contrary to Coren's argument, the D.C. Circuit's decision in *Tom Mistick & Sons, Inc. v. Reich*, 54 F.3d 900 (1995), does not provide conflicting authority. In *Mistick*, the employer elected to pay the fringe benefit portion of the prevailing wage by contributing funds into separate interest-bearing trust accounts for each employee who performed Davis-Bacon work. The Department of Labor, applying *Miree*, found that the employer had failed to pay the prevailing wage under the reasonable relationship test, because the employer, *Mistick*, did not show that its contributions to its benefits plan was reasonably related to the cost of providing fringe benefits to its

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161

(Cite as: 2008 WL 4488995 (E.D.N.Y.))

prevailing wage employees and that disbursements were made for non-*bona fide* benefits. The court of appeals disagreed. Specifically, the court held that the reasonable relationship test could not be applied to find noncompliance because prevailing wage workers were the sole benefactors of their individual trust accounts, and, further, there was no evidence that the benefits being distributed to those workers were for work on nonprevailing wage jobs. In such a circumstance, *Mistick* held that “[t]he one-to-one ratio between employer contributions on behalf of an employee and value received by the employee cannot be deemed unreasonable.” *Id.* at 704. Thus, *Mistick* did not reject the reasonable relationship test advanced in *Miree*, but rather found that, given the facts of *Mistick*, as a matter of law, the benefits plan adopted by the employer could not be deemed unreasonable.^{FN7}

^{FN7}. Here, by contrast, it is alleged-and must be accepted as true on this motion-that nonprevailing wage workers were receiving benefits from the CBT, whose contributions were *solely* made up from funds for which credit on prevailing wage obligations had been paid. Indeed, this case represents the exact opposite situation as that present in *Mistick*-here, the indictment alleges that prevailing wage employees were being underpaid, as nonprevailing wage workers were receiving benefits paid for exclusively by contributions credited as the payment of fringe benefit wages owed on prevailing wage work.

*11 Additionally, as the government points out, opinion letters published by the Department of Labor, support the same common sense interpretation:

Contrary to the defendant's assertions [] contributions for prevailing wage fringe benefits must, in fact, be made on behalf of, and calculated with respect to, each and every laborer....

When an employer makes a contribution to a trust that will not be used to purchase a benefit for that particular employee, no cost is incurred ‘with respect to’ that employee, and no credit is due under prevailing-wage law. It costs the employer exactly nothing to provide no benefits to an employee, and as the U.S. Department of Labor made clear in an opinion letter, “it should be kept in mind that if the

employer's cost (i.e. the employer's contribution) of providing this benefit does not equal the cost per hour for each individual employee[] set forth in the applicable wage determination, the employer must provide the difference in cash payments to the employees for all hours spend on covered work.” Opinion Letter, W & H, DBRA-144 (1973).

Furthermore, contributions made on behalf of one prevailing wage worker cannot be used to purchase benefits for another prevailing wage worker, let alone an employee or owner of the company who does not earn the prevailing wage. See Opinion Letter, W & H, DBRA-459 (1978) (“Just as the Department does not recognize a cash payment to one employee as meeting the employer's obligation to pay the prevailing wage rate to a second employee, neither does the Department recognize a fringe contribution on behalf of one employee as meeting the requirement to pay the prevailing wage to a second employee.”).

(Gov't Br. at 16.) It is a point the Court accepts.

Finally, no one can contest that the failure to pay prevailing wages has been the subject of past criminal prosecutions for making false statements and for fraud. See *United States v. Gotti*, 42 F.Supp.2d 252 (S.D.N.Y.1999) (defendant charged with mail fraud in connection with concealing co-defendant's presence on a construction project and failing to pay him the prevailing wage); *United States v. Shareef*, 190 F.3d 71 (2d Cir.1999) (conviction for failing to pay laborers the prevailing wage rate by means of conduct that violated the Hobbs Act); *United States v. Andrews*, 88 Fed. Appx. 903 (6th Cir.2004) (conviction for false statements to the Department of Labor regarding underpayment of prevailing wages). All that is novel here is the alleged mechanism of the scheme, not the criminal objective.

Taken together, the plain meaning of the language of the statute, its legislative history, regulatory clarifications and related interpretive caselaw gave more than fair warning that conduct such as charged here is criminal-prevailing wage credit cannot be claimed where it is intended beforehand that the workers on whose behalf the credit is taken will be ineligible to share the benefit. As applied, Davis-Bacon and Section 220 do not appear vague given the charges are grounded upon Coren's alleged participation in

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161
(Cite as: 2008 WL 4488995 (E.D.N.Y.))

devising and executing such a scheme to defraud federal and state agencies by intentionally claiming false prevailing wage credits for corresponding deposits made to the CBT. Whether the government can prove all that it alleges beyond a reasonable doubt, of course, is a matter for trial. What the indictment alleges, however, is enough to withstand Coren's constitutional challenge by motion before trial.

Did the indictment Properly Charge Coren's Participation in the Alleged Fraud

*12 Lastly, Coren argues that, even assuming *arguendo* the conduct of his client-contractors violated the prevailing wage laws, he cannot be held criminally liable because he did not advise his clients as to the propriety of any prevailing supplemental wage credit they claimed. According to Coren, determining the amount of prevailing wage credit that can be claimed by a contractor is an accounting function performed by the contractors, and outside his bailiwick as counsel or CBT trustee.

The indictment, of course, does not claim he did it alone. It charges Coren as an aider and abettor of his clients' alleged prevailing wage law crimes. In order to prove that he took part in the contractors' crimes, the government must demonstrate that the underlying crime was committed by the contractors and that Coren acted with the "specific purpose" of bringing about that crime. See *United States v. Best*, 219 F.3d 192, 199 (2d Cir.2000); see also *United States v. Pi-pola*, 83 F.3d 556, 562 (2d Cir.1996) ("to show specific intent [to aid and abet] the prosecution must prove the defendant knew of the proposed crime ... and had an interest in furthering it"); *United States v. Wiley*, 846 F.2d 150, 154 (2d Cir.1988) (finding that aiding and abetting requires the "specific intent that [the defendant's] act or omission bring about the underlying crime). More dispositively, on this motion, the question is only whether the indictment alleges sufficient facts to support such charges. While Coren's involvement in the contractors' fraud will undoubtedly be the issue for trial, the indictment clearly alleges that Coren devised the CBT with the specific intent to help contractors shirk their prevailing wage obligations and divert money that should have been spent on benefits for prevailing wage workers back into their own pockets. That is enough.

Coren's last hope collateral attack fails too. The gov-

ernment's concession that Coren, as trustee, committed no ERISA violation cannot serve as a *deus ex machina* to short-circuit prosecution. Coren was not, as he claims, caught in the "Catch-22" of having to choose between compliance with his duties as trustee under ERISA and compliance with Davis-Bacon. Here again, Coren fundamentally misconstrues the allegations of the indictment. Coren is not charged with violating prevailing wage law owing to his function as the creator and/or trustee of the CBT. He is charged with advising and counseling his client-contractors to overstate their prevailing wage payments to their state and federal contracting partners. Whatever the status of a hypothetical ERISA trustee who unwittingly assists employer-trust contributors in avoiding their prevailing wage obligations, those are not the facts alleged in this indictment.^{FN8}

FN8. Also, Coren essentially attacks the obstruction of justice charge in count 17 as a derivative of his forecasted success in his attack on the substantive counts that precede it. Since that attack has failed, the challenge asserted against count 17 is academic and the motion to dismiss it is denied.

Conclusion

Accordingly, for all these reasons, Coren's motion to dismiss the indictment is denied in its entirety.

SO ORDERED.

E.D.N.Y.,2008.

U.S. v. Coren

Not Reported in F.Supp.2d, 2008 WL 4488995 (E.D.N.Y.), 44 Employee Benefits Cas. 2679, 14 Wage & Hour Cas.2d (BNA) 161

END OF DOCUMENT