

# BUSINESS REPORT

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## IRS Waffles In Different Direction

One of the basic premises of tax law is that an employee must treat every taxable benefit he or she is entitled to receive as taxable income, whether or not the employee has actually received that benefit. However, the Internal Revenue Service in a Private Letter Ruling last year headed in a different direction. It permitted an employer that was having problems attracting new employees, to give those new employees the choice of selecting whether they wanted a higher wage with reduced welfare benefits or a lesser wage with better benefits.

Issues like this have become more common where both spouses are working and able to select one spouse's medical or life insurance coverage and drop the other spouse's insurance. While this situation has existed for a long time, the IRS always had taken the position that an employee would be taxed on the dollar amount of the highest wage the employee could get, even if the highest wage

could only be obtained by giving up nontaxable medical and life insurance benefits.

The specific facts involved in this Private Letter Ruling were that the employer was losing a significant number of applicants and employees who did not want the welfare benefits, but would take the job at the higher wage. The employer knew it would create

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**Employers who have problems attracting new employees now can offer higher wages than they are presently paying if benefits are not needed.**

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employment problems internally if it did not offer the same option to its existing employees. A new hire might be getting a higher wage for doing the same job if the new employee surrendered any rights to benefits.

To avoid the in-fighting, the employer did offer this election option to both existing employees and new hires and required that the employee or applicant must make an irrevocable election to remain in the existing employee benefits program or switch to the new program (which paid 8% more but had no insurance benefits). Without much of an explanation, the IRS said that so long as this election was irrevocable, the employees who elected to receive the higher benefits package would not be taxed at the higher rate of pay that they could have received had they selected the lower benefit program.

No explosions have been seen in the IRS or Congress since this Private Letter Ruling came out last year. If one of your problems is attracting employees who want a higher wage than you are presently paying but don't need benefits, this may be an option worth considering. However, since this Private Letter Ruling was issued on Valentine's Day last year, our hope is that it was not a fleeting romance for any employer who decides to go this route.

If you have any questions, please contact Terry Cullen.

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# COBRA Only Requires Notice, Not Blood

One of the questions that regularly arises for our clients is how they should deliver the COBRA Notice to an employee and his or her family after termination of employment. Hand delivery of the COBRA Notice is permitted. However, if the employee was terminated or left after an argument, a hand delivered COBRA Notice frequently ends up in pieces on the floor with the employer wondering whether the COBRA Notice ever ended up getting to the family members who were covered. While hand delivery is permitted, it is dangerous unless the employee acknowledges receipt in writing.

A more frequently used method of delivery is the U.S. Postal Service. Some employers that we work with send the COBRA Notice by certified mail, return receipt requested, to verify receipt of the COBRA Notice by the employee and family. In addition, use of certified mail provides a record that the notice was actually sent when the employer put it in the mail addressed to the employee.

A recent decision by a Federal Court of Appeals confirms that an employer who

sends the notice by first class mail has complied with its obligation under COBRA to use a method of notification which is reasonably calculated to reach the employee or beneficiary even if the certified letter is never delivered by the post office or picked up by the Plan participant. *Degruipe v. Sprint Corp.*, 27 EBC 1505 (CA 5 2002).

The *Degruipe* Court specifically stated that an employer can hand deliver a letter to an individual or send a letter via first class mail to accomplish the employer's obligation to act in good faith in delivering the COBRA notification. However, the *Degruipe* Court stated that the employer acted in good faith by putting the letter in certified mail even if that letter eventually was returned to the employer and wasn't delivered because it had not been picked up by the Plan participant.

Our recommendation generally is that an employer start its obligation to provide notice by sending a letter via first class mail, keeping a copy of the letter and record of who in the company sent the letter through use of a COBRA log. Although use of certified mail may provide some greater proof that the letter was sent, our experience has been that it does not increase the probability that the former employee will actually receive the notice.

Former employees don't always go down to the post office to pick up a letter after they have terminated employment.

Whatever method you decide on, make sure that someone in your company is prepared to testify that they know the COBRA Notice was sent. He or she should be able to produce a copy of the notice with the employee's name and last known address on it and a log showing the date it was put in the mail. The last problem you need is to try and prove a COBRA Notice was sent without those records when the employee is claiming it was never received and enormous medical bills are owed.

If you have any questions, please contact Terry Cullen or Eva Lastovich of our Minneapolis office.

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## Welcome Aboard

The law firm of Felhaber, Larson, Fenlon and Vogt, P.A. is pleased to announce that Karen Ciegler Hansen has joined the firm, with offices in downtown Minneapolis and St. Paul. Ms. Hansen has over twenty years of experience, concentrating her practice in estate planning, probate and trust administration.

Ms. Hansen graduated from the University of Illinois at Urbana-Champaign in 1976 with her B.A. and in 1980 with her J.D. She is a member of both the Hennepin County and Ramsey County Bar Associations.



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# He's Not Heavy, He's Just Diseased

A recurring question in many people's lives is whether their medical insurance policy will pay the cost of a weight loss program for them or an overweight dependent. In addition, a related issue is whether the cost of the weight reduction program is a tax-deductible medical expense for federal income tax purposes.

In a revenue ruling issued by the Internal Revenue Service in April, 2002, the IRS reversed its early rulings. The IRS held that the cost of uncompensated amounts paid by individuals for participation in a weight loss program, as treatment for a specific disease or ailment or obesity, is tax deductible. The IRS held that so long as the individual is diagnosed as having a disease related to being obese (such as obesity or hypertension) and is directed to lose weight by his or her physician as treatment for the disease, the cost of the weight loss treatment is a deductible medical expense for federal income tax purposes. The revenue ruling goes on to say that the deductible expense includes the initial fee and any additional fees needed to attend periodic meetings.

In its revenue ruling, the IRS stated that there is no longer any question that obesity is medically accepted as a disease in its own right. Thus, so long as a physician diagnoses a patient as suffering from the disease of obesity, the cost of the patient's participation in the weight loss program is treatment for medical care under Section 213 of the Internal Revenue Code 26 USC.

The IRS went on to state that the same situation does not apply to individuals who are not suffering from any specific disease or ailment and participate in a weight loss program to improve the tax payer's general health or appearance. In addition, the Internal Revenue Service said that the tax

payers cannot deduct the portion of the cost of purchasing low calorie diet foods because those foods are merely substitutes for the foods the tax payers normally consume to satisfy their nutritional requirements.

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**This revenue ruling deals only with whether the cost of the weight loss program is deductible and not whether an insurance company or medical benefit plan must pay for the cost of the insurance.**

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While the IRS' revenue ruling clarified its position on whether and when weight loss programs are a tax-deductible medical expense, this revenue ruling deals only with whether the cost of the weight loss program is deductible and not whether an insurance company or medical benefit plan must pay for the cost of this benefit. Most medical insurance plans exclude coverage for weight loss programs; nothing in this ruling will require them to change that policy. However, if an individual truly has a weight loss problem that is diagnosed by a physician as a disease, the individual will be able to seek help at a weight loss program and may be able to deduct it on their federal tax return.

If you have any questions, please contact Terry Cullen of our Minneapolis office.

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## COMPLIMENTARY CLIENT SEMINARS

Consider attending one of our upcoming seminars, with timely discussions on a variety of legal topics. The seminar presenters include our firm attorneys who have expertise in the seminar subject matter.

Recent seminars we have hosted include the following topics: estate planning, labor and employment, real estate, and multiemployer benefits.

Most seminars include a complimentary continental breakfast and luncheon. Here is what seminar attendees had to say about Felhaber seminars . . .

*"Many thanks for inviting me to your Estate Planning Seminar . . . I thoroughly enjoyed the seminar, and the opportunity to see some old friends in the insurance field. It was very well done, instructive, and heavy enough to make it truly worth while."*

At Felhaber's annual Employment Law Seminar . . .

*"Wonderful information and good presentation. You have a wonderful team and work very well together. FMLA information will be very helpful."*

Here is a listing of some of our upcoming seminars. Let us know if you are interested in receiving a seminar invitation by emailing [kdyck@felhaber.com](mailto:kdyck@felhaber.com). State your name and address with the name of the seminar you wish to attend. You may also log on to [www.felhaber.com](http://www.felhaber.com), which will have online seminar registration available approximately three weeks ahead of the seminar date.

### Upcoming Seminars

Real Estate Seminar for Builders and Developers – June 19

Healthcare/HIPAA Seminar  
Mid September

Labor & Employment Law Seminar  
Late October

Real Estate Seminar for Leasing Brokers, Property Managers and Tenant Representatives – November 6

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*Business Report* is an update on legal developments. It is not intended to be legal advice and should not be relied on without consulting counsel.

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