

THE  
**JURIS DOCTOR**  
SMALL BUSINESS WATCH

Daniel H. McKinney & Associates  
Small Business Planning Group

A NEWSLETTER FOCUSING  
ON PLANNING FOR THE  
SMALL BUSINESS

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**INACCURATE EMPLOYEE BENEFIT DOCUMENTS OBLIGATE COMPANY  
TO UNEXPECTED PAYMENT OF RETIREMENT BENEFITS.**

Kenneth Burke was an employee of Kodak for twenty-seven years. Before their marriage in May, 1999, he and Sally Burke lived together for eight years as domestic partners. In the fall of 1999, Mr. Burke died after the couple had been married for less than six months.

Mr. Burke participated in a portion of Kodak's employee benefit program known as the pre-retirement Survivor Income Benefits Plan (SIB) which provided payments to spouses and domestic partners if the employee died before retirement. The plan and sixteen sections of the 300 page Summary Plan Description\* required domestic partners to file joint affidavits in order to be eligible for various types of benefits. However, the SIB section of the Plan Description did not mention the affidavit requirement.

After Kenneth Burke's death, Kodak ultimately informed Mrs. Burke she was ineligible for benefits as a spouse because she had been married for less than a year and ineligible for benefits as a domestic partner because she and Kenneth Burke failed to file the joint affidavit. Mrs.

Burke then sued claiming that although the Plan itself required the affidavit, the Plan Description did not.

The district court agreed with the plan administrator's decision to deny benefits to Mrs. Burke. That court noted that the affidavit requirement for domestic partnership status could not be clearer. It was spelled out sixteen times in various sections of the plan - each time stating:

*An affidavit of Domestic Partnership must be signed by you and your domestic partner and filed with Kodak in order to qualify your domestic partner for plan benefits.*

The court of appeals disagreed. None of these references is located in the self-contained section describing SIB. Of the sixteen references in the Plan Description, four pertain to health care, four to dental insurance, seven to dependent life insurance, and one to long-term care insurance. A SIB participant should not be expected to look at other self-contained benefit sections of a 300 page Summary

Plan Description to determine eligibility for SIB. So, although the Plan required the affidavit for SIB benefits, the Summary Plan Description omitted the requirement. When the Summary Plan Description and the Plan conflict, the Summary Plan Description controls. Mrs. Burke is entitled to SIB benefits as a domestic partner.

The moral of the story? Plans are creatures of strict interpretation and it is difficult to obtain benefits where there has not been perfect compliance with plan requirements. However, as this case demonstrates, there is hope for those who find themselves in these circumstances. For employers, this case illustrates the need for absolutely accurate drafting. Failure to do so can expose the plan to liability for unexpected payment of benefits which have not been actuarially accounted for.

\* a summary of the plan benefits, sponsor, fiduciary, and claim instructions.

*Burke v. Kodak Retirement Income Plan et al (2<sup>nd</sup> cir, 2003)*

## BILL PASSED BY HOUSE WOULD PERMIT SMALL BUSINESSES TO JOIN TOGETHER TO PROVIDE HEALTH COVERAGE

The House of Representatives has passed the Small Business Health Fairness Act which purportedly will help uninsured working families obtain health care benefits. According to the news release from The House Committee on Education and the Workforce, while more Americans may be finding jobs, many small businesses can't afford to provide health insurance because of the cost. The bipartisan bill would increase small businesses' bargaining power & put small businesses on a par with big businesses and labor unions. Small business owners would be able to band together, even across state lines, through membership in a bonafide trade association like the U.S. Chamber of Commerce to form group health plans\*. The trade association would act as a human resources office to provide economies of scale, purchasing clout and administrative efficiencies. Companion legislation is pending in the

Senate\*\*.

According to the Committee's press release, the bill is endorsed by 180 groups including the U.S. Chamber of Commerce, the National Federation of Independent Business, The American Farm Bureau Federation, Associated Builders and Contractors, The Latino Coalition, The National Black Chamber of Commerce, The National Association of Women Business Owners, and the National Restaurant Association.

On the other hand, the bill is opposed by the National Association of Insurance Agents (NAIA) which claims that Association Health Plans would threaten the stability of the small group market and provide inadequate benefits and protection to consumers.

\* known as Association Health Plans

\*\* (S. 545)

## DANGER OF NONFORFEITURE CLAUSE

Gilbert Thompson owned 80 shares of Thompson Printing Co. and Gerald Fields owned the remaining 20 outstanding shares. On May 7, 1990, Fields entered into an employment contract with TPC naming him vice president and chief operations officer. The contract ran until June 14, 2000. If Fields voluntarily left the company, TPC had the right to discontinue contractual benefits but if TPC terminated Field's employment, all benefits would continue under a nonforfeiture clause. The contract did not differentiate between termination with or without cause. On August 11, 1997, three female employees made allegations to Thompson that Fields had sexually harassed them. Two days later, Thompson phoned Fields and fired him. TPC refused to pay Fields any further compensation.

Fields filed suit seeking reinstatement of his salary and benefits. One of the arguments TPC made was that contracts that violate statutes, promote crime, interfere with the administration of justice, or violate public morality were unenforceable and since statutes prohibited sexual harassment, the contract was, thereby, unenforceable.

The court, however, did not accept this

argument. The contract did not require TPC to reinstate anyone who may have engaged in sexual harassment. It only required TPC to pay certain sums of money if it terminated Fields. Courts will not review every employment contract to determine if it is desirable from a public policy standpoint.

TPC also argued that Fields breached the implied covenant of loyalty, good faith and fair dealing inherent in Field's employment. The breach destroyed TPC's ability to reap the benefit of Fields' services by making it impossible to continue his employment. In other words, since Fields breached, TPC did not have to pay.

The court did not accept this argument either. Even if Fields committed the acts and the termination was justified, the express terms state that if he is terminated, benefits will continue. Implied covenants cannot be used to alter the express terms of a contract.

Since no one has a crystal ball, contracts, or parts of contracts, that cannot be terminated under any circumstances, should be entered into only with extreme caution.

(Fields v. Thompson Printing et al, (3<sup>rd</sup> cir, 2004)

## DOMESTIC PARTNERS MAY EXCLUDE HEALTH CARE BENEFITS FROM GROSS INCOME - SOMETIMES

Although some companies have extended healthcare benefits to domestic partners, employers were unsure whether benefits should be included in the employee's gross income. The IRS has answered the question through a private letter ruling in response to an inquiry posed by a corporate employer.

This employer provides medical and dental benefits for employees, spouses and "eligible dependents" through a welfare benefit plan. Domestic partners are "eligible dependents"\* for purposes of the plan. The employer and employee share the costs. If a domestic partner does not qualify as a dependent under the tax code\*, the employer includes the taxable portion of the benefits received by the domestic partner in the employee's gross income. If the partner qualifies as a dependent, the employer does not include the coverage paid by the employer in the employee's gross income.

After analyzing multiple code sections and various revenue rulings the IRS concluded:

1. Employer contributions for medical coverage for an employee, his spouse, and dependents are not included in an employee's gross income.
2. An employee's same gender domestic partner does not qualify as a spouse.

3. A domestic partner who is not related to the employee may qualify as a dependent if all of the code requirements are met.
4. Costs for medical and dental coverage for a dependent domestic partner do not need to be included in the employee's gross income.\*\*
5. The value of coverage provided to a domestic partner who is not a dependent is included in the employee's gross income and is subject to income and employment tax.\*\*

The conclusions in the private letter ruling are limited to these exact facts.

(IRS Letter Ruling 20039001)

\*Dependant is : Son/daughter or descendent of either; stepson/stepdaughter; brother/sister; stepbrother /stepsister; father/mother or ancestor of either; stepfather/stepmother; brother/sister of father/mother; son-in-law/daughter-in-law; father-in-law/mother-in-law, brother-in-law/sister-in-law --half of whose support was provided by the taxpayer for that year.

And

An individual who is not a spouse, who has as his or her principal abode the home of the taxpayer, who is a member of the taxpayer's household, who has had half of his support provided by the taxpayer for that year,—provided that the relationship was not in violation of local law.

## LLC'S MAY PROVIDE PROTECTION AGAINST IRS

For tax purposes, a multimember LLC can elect to be treated as a corporation or a partnership under the "check the box" regs. If no election is made by the LLC, the company is treated as a partnership, which in many circumstances, is very desirable.

State law generally provides that the general partners of a partnership are jointly and severally liable for the partnership's debts meaning that a creditor, including the IRS, can collect from the partnership, any one of the partners, or all of the partners.

State law also generally provides that the members of an LLC are not generally liable for the debts of the LLC just as shareholders are generally not liable for the debts of a corporation.

The LLC has become very popular because it combines the advantageous, tax benefits of a

partnership with the limited liability of a corporation - in others words, the best of both worlds.

However what happens when the LLC owes federal employment taxes? Can the IRS collect from the individual members if the LLC is treated as a partnership for tax purposes?

The IRS, in a recent revenue ruling, said no. The IRS cannot collect unpaid tax obligations of the LLC from the individual members if under state law the members are not liable for the debts of the LLC. However, the IRS cautioned that certain circumstances, could give rise to liability for members. Specifically mentioned was liability after a fraudulent transfer or liability under another provision the code which imposes a penalty on anyone who is required to collect and pay the tax and who wilfully fails to do so\*. (Cont'd p. 4)

(Cont'd from p. 3)

Also beware, where the LLC is owned by a single member, the result is not the same. In that situation, the LLC is disregarded and the member cannot escape liability.

\* Internal Revenue Code Section 6672

(IRS Rev Ruling 2004-41)

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