



NEW MENU OPTIONS FOR CAFETERIA PLANS: PROPOSED REGULATIONS ADD WELCOME ENTREES

At long last, the IRS issued new Proposed Regulations governing cafeteria plans, and followed the next week with new dependent care assistance plan (DCAP) rules. These new regulations replace existing proposed regulations, codify prevailing interpretations of existing regulations, add new compliance requirements, and importantly, add new flexibility and benefits for plan sponsors.

Our task is clear—all cafeteria plans must adopt the new Regulations for plan years beginning on or before January 1, 2009. *BUT*, some provisions of the new Regulations are effective now. We recommend that plan sponsors should begin their review and document updates immediately. Many provisions which are not mandated until 2009 provide quite welcome relief from current rules, and plan sponsors should consider immediate adoption of these allowable provisions.

TPAs and other service providers likewise should prepare to implement these new rules immediately for plan sponsor clients that want to take current advantage of the changes. New clients will likely want to incorporate the most current changes into their documents, and progressive plan sponsor clients will be anxious to begin this process as well.

The Proposed Regulations are quite voluminous, and are difficult to summarize within our self-imposed two-page limit (in this case, three-page limit) on these Alerts. With that limit in mind, here is a partial list of the highlights, along with our comments in italics:

Document Requirements. Plan documents must add new required provisions. The rules also clarify that a plan that has no document or a faulty document, or that fails to follow its document, is not a cafeteria plan and the plan balance is subject to immediate taxation.

No surprise here—the IRS wants to see a clean and current document.

Plan Year Changes. Plan year changes and short plan years are permitted only for valid business purposes.

Grace Period. The regulations clarify that any grace period provision may apply to one or more benefits, but must state that unused contributions for one benefit component, such as the Health FSA, cannot be used to reimburse for another benefit component, such as the DCAP.

This clarification addresses perceived current abuses of the relatively new grace period.

Participants. The plan must state that only employees may participate. Self-employed individuals and >2% shareholders of an S corporation may not participate in a cafeteria plan. A plan may allow laid off, retired and other former employees to participate so long as the plan is not maintained predominantly for former employees.

In order to have a retiree only plan, it is now clear that a VEBA is the only option.

Dependents. The term “dependent” for purposes of cafeteria plans will have the same meaning as the term “dependent” for purposes of the applicable qualifying benefit, *i.e.*, major medical plan.

It's now more clear which definitions apply, but it would still be nice to have a uniform definition.

Dependent Care and Adoption Assistance Programs. New requirements apply to exclude up to \$5000 of employer provided assistance for dependent care and adoption assistance programs.

Premium Payments. Individuals may pay COBRA premiums, and premiums on individual health insurance policies, through a cafeteria plan.

Allowing individual premiums fits squarely with the current administration's emphasis on consumerism and individual responsibility for health care.

Dental and Vision Premiums. Individuals may also pay vision or dental premiums with a two-year lock-in provision, so long as premiums for each plan year are paid at least annually, and payments in the first year are not applied to coverage for the second year. Premiums from the last month of a cafeteria plan year can pay accident and health premiums for the first month of the next plan year.

Group Term Life Insurance. Salary reductions for group term life insurance in excess of \$50,000 are not taken into account when determining the amount to include in an individual's taxable income for the excess coverage. However, the employee must still include the Table I cost of the excess coverage.

Elections. New employees may have 30 days from date of hire to elect. Elections must be made from compensation not currently available. This relaxed rule does not apply to certain rehired employees. Plan sponsors may adopt default elections for employees who fail to make timely elections. Elections may be made electronically, so long as the current safe harbor rules for electronic elections are satisfied.

Many plan sponsors will be pleased to see the election provisions open up to tardy employees.

Orthodontia and DME. Plans may reimburse for orthodontia services, so long as the employee made the payment in order to receive the orthodontia services. Likewise, plans may reimburse for durable medical equipment even if the useful life of the equipment extends beyond the period of coverage.

No guidance yet on similar questions with respect to the similar issues respecting prenatal programs or infertility treatment.

Limiting FSA Enrollment. Plans may limit FSA enrollment to participants in an employer accident and health plan.

Electronic Card Programs. Card programs must automatically cancel when employees cease participation in the FSA. This new rule allows cards to be used by COBRA continuees. Employers must ensure that an inventory information approval system (IIAS) complies with required substantiation requirements.

Be prepared for more changes in this area as technology continues to expand.

Substantiation. Participants in post-deductible health FSAs must provide independent third party substantiation that the HDHP deductible has been satisfied. Likewise, participants in limited purpose health FSAs must provide independent third party substantiation that expenses are for the covered limited purpose (dental, vision or preventative care.)

Nondiscrimination Rules. New definitions apply for “highly compensated employees” and “key employees.” A safe harbor is established for premium only plans. New guidance applies to the contributions and benefits test. Plans must test as of the last day of the plan year, and the test must account for all non-excludable employees and former employees who were employed on any day during the plan year.

What benefit statute is complete without changes to the applicable nondiscrimination rules?

What’s Next? As you can see, there are some very favorable provisions in the new Proposed Regulations. We suggest that plan sponsors consider adopting these provisions immediately, along with the provisions that take effect immediately. We also encourage TPAs and other service providers to start drafting new model agreements to account for the Proposed Regulations.

For more information, please contact Haynes Benefits at 816.875.1919 or visit www.haynesbenefits.com