



## **CAFETERIA PLAN COMPLIANCE**

Many of you have heard about the proposed regulations for cafeteria plans (also known as “Section 125 plans” or “Premium Only Plans”) that were issued by the Internal Revenue Service in mid-2007.

These proposed regulations stated that the final cafeteria plan regulations would become effective on January 1, 2009. At this point, however, the Internal Revenue Service has yet to issue the final cafeteria plan regulations. The final regulations aren’t expected until sometime during 2009 and will have a delayed effective date (likely in 2010).

So what do you need to be doing now (assuming your documents complied with the prior regulations)?

### **Change Your Plan Document**

When the final regulations are issued, you will need to make changes to your written cafeteria plan documents to comply with the new rules. While there is no absolute requirement that you take steps now to revise your written cafeteria plan document, since good faith compliance is required while the final regulations are pending, you should make sure that your written cafeteria plan document includes the mandatory provisions described in the proposed regulations. Depending on the current state of your cafeteria plan document and who drafted it, good faith compliance could mean that an amendment to your cafeteria plan is wise (but not required). Your cafeteria plan should be memorialized in a written document (although it may be comprised of multiple documents).

- Your cafeteria plan document should describe the benefits being offered under the plan. The proposed regulations allow the cafeteria plan document to incorporate by reference the benefits offered through another separate written plan.
- Your cafeteria plan document should describe the coverage period for benefits (for example, grace periods for flexible spending accounts).
- Your cafeteria plan document should describe the rules governing eligibility (including a statement that only employees may participate), election procedures, the manner in which contributions are made, the maximum amount of contributions, and the plan year.

### **Operate Your Plan in Good Faith**

- Until additional guidance is issued, you should make good faith efforts to operate your cafeteria plan in that the final regulations will substantially improve, and clarify the nondiscrimination testing rules for cafeteria plans.

- Perform nondiscrimination testing. The proposed regulations describe non-discrimination requirements with respect to eligibility, contributions, and benefits. There is a safe harbor for premium only cafeteria plans. The easiest way to comply with nondiscrimination rules is to ensure that all employees are offered the same benefits at the same premiums. It is expected that the final regulations will substantially improve, and clarify the nondiscrimination testing rules for cafeteria plans.
- Substantiate claims for benefits. Note that specific rules apply to debit cards used for reimbursements under a Health FSA.

### **Consider Permissive Changes**

Following are several new permissive provisions in the proposed regulations that you may choose to adopt by amending your written cafeteria plan document:

- Health flexible spending accounts reimbursements are allowed for services that are expected to last for several years (such as orthodontia work) and durable medical equipment with a useful life beyond the year (such as wheelchairs). Additionally, Health FSAs may provide the maximum reimbursement amount available by making reimbursements payable on a monthly basis or by establishing a reasonable minimum amount for reimbursements.
- A dependent flexible spending account may reimburse qualified dependent care expenses incurred after termination of employment.
- A new type of flexible spending account for adoption assistance is allowed.
- Default election(s) for one or more qualified benefits for employees who fail to make an election is allowed.
- Employers may retain experience gains and surpluses for their own use.
- New employees may be allowed up to 30 days after the date of hire to make elections under the cafeteria plan that are retroactively effective back to their date of hire.
- Cafeteria plans may allow employees to pay COBRA premiums under a group health plan (where the COBRA coverage is otherwise tax-free to the employee).
- While not under the proposed regulations, the Heroes Earnings Assistance and Relief Tax Act of 2008 permits cafeteria plans to provide a distribution to reservists of unused amounts in a Health FSA.

If you wish to take advantage of a provision that is allowed under the proposed regulations, you can amend your cafeteria plan in reliance on the proposed regulations. But, reliance on any new permissive provision under the proposed regulations means that you are complying with the other provisions of the proposed regulations, including the prohibition against retroactive amendments. Therefore, it would be wise (but not required) to amend your cafeteria plan document now if you wish to take advantage of any of the new permissive provisions.

### **Briefing on Final Regulations**

Once the final regulations are issued, we have arranged to provide you a briefing by our legal advisors. They will provide you information on the actions that you must take for compliance with the new requirements and provisions of the new rules that may help your business. In the meantime, let us know if you wish to discuss the current status of your cafeteria plan.