

Section 125 Cafeteria Plans Administration Issues for Employers

March 21, 2013



Section 125 Cafeteria Plans

Administrative Issues for Employers

- Welcome! We will begin at 1 p.m. Eastern
- There will be no sound until we begin the webinar. You can listen to the audio portion through your computer speakers or by calling into the phone conference number provided in your invitation email
- You will be able to submit questions during the webinar by using the “questions” box located on your webinar control panel



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- Lyons Companies
- The McCart Group
- MJ Insurance
- Parker, Smith & Feek
- Payne West Insurance
- R&R/The Knowledge Brokers
- RCM&D
- The Rowley Agency
- Senn Dunn Insurance
- Smith Brothers Insurance
- Van Gilder Insurance
- Woodruff-Sawyer & Co.
- John L. Wortham & Son



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Agenda

- **Cafeteria Plan Basic Concepts**
 - Constructive Receipt
 - 2007 Proposed Regulations
- **Common Cafeteria Plan Administrative Issues**
 - H-FSA Transition to HSA
 - Status Changes
- **Cafeteria Plans and the Affordable Care Act**
 - H-FSA Salary Reduction Limitation
 - New Mid-Year Election Opportunity
 - Miscellaneous ACA Provisions



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Cafeteria Plan Basic Concepts

- **Constructive Receipt** (IRC §1.451-2(a))
 - Income... is constructively received... in the taxable year during which it is credited to his account, set apart for him, or otherwise made available...
 - Income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.
- **IRC §125 Allows Us to Ignore Constructive Receipt If Certain Conditions are Satisfied**
 - Plan must provide a choice between at least one taxable and one non-taxable benefit (the *sine qua non* of cafeteria plans)
 - Cannot defer either income or benefits from one tax year to another
 - Elections once made are irrevocable



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Cafeteria Plan Basic Concepts

- **We Cannot “Turn Our Back” on Income Already Received**
 - All pre-tax elections must be made prospectively
- **August 2007 (re)Proposed Cafeteria Plan Regulations**
 - Rescinded both temporary and never finalized proposed regulations issued in 1984, 1986, 1989, 1997 and 2000 as well as additional sub-regulatory guidance
 - Essentially consolidated and restated prior guidance
 - Also addressed key changes in the law during intervening years
 - In that prior guidance was rescinded, 2007 proposed regulations “may be relied upon until finalized,” but... it hasn’t happened yet!



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Cafeteria Plan Basic Concepts

- **Key Changes in 2007 (re) Proposed Regulations**
 - Reflect the changes in the definition of “dependent” under the IRC
 - Recognition of new qualified benefits – *e.g.*, adoption assistance and HSA contributions
 - New rules regarding qualified transfers from H-FSAs to HSAs
 - Reinforced the prohibition against providing long-term care coverage through a cafeteria plan
 - The addition of a “key employee concentration” discrimination test
 - Formalized the requirement for a written cafeteria plan document **and** requires that all amendments to the document be drafted and executed **prior** to the effective date of the change



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Cafeteria Plan Administrative Issues

H-FSA Transition to HSA

- **HSA Background**
 - Benefit comprised of two components: a HSA and a HDHP
 - In order to contribute to a HSA the employee must be an “eligible individual,” which means...
 - Is covered under a HDHP, and
 - Is not enrolled in Medicare, and
 - Cannot be claimed as a dependent on another individual’s tax return, and
 - Is not covered by another health plan that is not a HDHP
 - some exceptions allowed



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Cafeteria Plan Administrative Issues

H-FSA Transition to HSA

- **If There's No Grace Period... *No Problem!***
- **If There is a Grace Period... *The Devil is in the Details!***
 - If H-FSA balance is zero on the last day of the plan year, employee is an “eligible individual” and may contribute to an established HSA the next day
 - If there is any remaining balance in the H-FSA, employee does not become an “eligible individual” until the first of the month following the end of the grace period
 - There is no “middle ground”



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Cafeteria Plan Administrative Issues

H-FSA Transition to HSA

- **Transition Options / Recommendations**
 - If there are assets remaining, there is nothing to preclude use of the H-FSA's grace period while covered under the HDHP
 - Consider amending the cafeteria plan to convert to a limited scope and/or post deductible H-FSA upon participation in a HDHP
 - Communicate early and communicate often!
 - Make sure cafeteria plan document reflects intent and is both amended (if necessary) and executed **prior** to the effective date of the change
 - Remember the HSA "last-month rule"



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Cafeteria Plan Administrative Issues

Status Changes

- **Basic Requirements** (IRC §1.125-4))
 - Must be permitted under the Code
 - Revised election must be “consistent” with the nature of the status change
- **The Code indicates what is permitted... not what is required**
 - Therefore, recognition of status changes becomes a plan design consideration
 - The cafeteria plan document is always the ultimate source to determine whether a particular status change is recognized by the plan



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Cafeteria Plan Administrative Issues

Status Changes

- **Changes in Status**

- Change in status (most common)... *e.g.*, marriage, birth, adoption of a child and various employment status changes
- Cost or coverage changes... *e.g.*, significant increase or decrease in the cost or benefits provided, significant expansion or curtailment of coverage
- Accommodation of other laws... *e.g.*, HSA, COBRA, HIPAA, and now the ACA



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Cafeteria Plan Administrative Issues

Status Changes

- **Change in Status Includes Six Categories of Events**
 - Change in employee's marital status
 - Change in the number of dependents
 - Change in employment status
 - Dependent satisfies or ceases to satisfy definition of dependent
 - Change in residence
 - Commencement or termination of adoption proceedings
- **Benefits Eligible for Revised Mid-Year Election**
 - Applies to all qualified benefits as long as change in election is consistent with the nature of the event



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Cafeteria Plan Administrative Issues

Status Changes

- **Cost or Coverage Changes**
 - Cost changes with automatic adjustment of participant contributions
 - Significant cost changes
 - Significant curtailment of benefit or loss of benefit option
 - Significant expansion of benefit or addition of benefit option
 - Change in coverage under another employer's plan
- **Benefits Eligible for Revised Mid-Year Election**
 - Applies to all qualified benefits except for H-FSA



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Cafeteria Plan Administrative Issues

Status Changes

- **Accommodation of Other Laws**
 - HIPAA Special Enrollments – Applies to all group health plans that are not HIPAA “excepted benefits”
 - COBRA Qualifying Events – Applies to group health benefits subject to COBRA including H-FSAs
 - Judgments, Decrees or Orders – Applies to all accident and health benefits including H-FSAs
 - Medicare or Medicaid Entitlement – Applies to all accident and health benefits including H-FSAs
 - FMLA Leaves of Absence – Applies to all accident and health benefits including H-FSAs and non-health benefits
 - HSA Contributions – Applies to HSA contributions that flow through the cafeteria plan



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Cafeteria Plan Administrative Issues

Affordable Care Act

- **Maximum H-FSA Salary Reduction Limitation**
 - Limited to \$2,500 per employee year
 - If employee participates in multiple H-FSAs maintained by members of a controlled group or affiliated service group a single \$2,500 limit applies
 - If employee participates in multiple H-FSAs maintained by separate employers the \$2,500 limit applies to each employer
 - Spouses are each eligible for the \$2,500 maximum even if they are participants in the same plan



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Cafeteria Plan Administrative Issues

Affordable Care Act

- **Maximum H-FSA Salary Reduction Limitation**

- Limit is effective for plan years starting on or after January 1, 2013
- Limit does not apply to non-elective employer contributions to the H-FSA... but if employees have the option to receive employer contributions as cash the \$2,500 limit applies
- If the H-FSA includes a grace period, unused contributions carried over into the grace period do not reduce the subsequent year's limit
- Plan documents must be formally amended to reflect the new limit... but employers have until December 31, 2014, to amend the plan document and adopt the change



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Cafeteria Plan Administrative Issues

Affordable Care Act

- **New Mid-Year Election Opportunity**
 - Special transition rule allows one mid-year election change (without the occurrence of an otherwise permitted status change) in order to:
 - Discontinue coverage through an employer sponsored plan in order to secure coverage through an exchange, or
 - For individuals not covered under their employer sponsored plan, to enroll in the plan to avoid the individual responsibility payment.
 - The cafeteria plan may be amended retroactively to implement these rules, however...
 - the plan document must be amended by December 31, 2014, and
 - the change must be effective as of the first day of the 2013 plan year.



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Cafeteria Plan Administrative Issues

Miscellaneous ACA Provisions

- **Pre-Tax Exchange Coverage**
 - Exchange coverage generally is not a qualified benefit for pre-tax treatment under a cafeteria plan
 - However, small employers that purchase group coverage through an exchange may allow employees to pay for such coverage on a pre-tax basis through the employer's cafeteria plan
- **OTC Drugs Require a Prescription for Reimbursement from H-FSAs and HRAs**
 - Reversed prior treatment
 - Effective January 1, 2011



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Cafeteria Plan Administrative Issues

Miscellaneous ACA Provisions

- **Simple Cafeteria Plans**

- Available to employers with < 100 employees in either of the two preceding years
- Can maintain plan until the year after employer attains ≥ 200 employees
- All employees with $\geq 1,000$ hours must be eligible
- Employees must receive employer contribution of at least:
 - 2% of employee's compensation, or
 - The lesser of 6% of employee's compensation or twice the employee's salary reductions
- Avoids nondiscrimination rules for cafeteria plans and most component benefits



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