

2007 Labor and Employment Law CLE Conference

**Hot Topics in Employee Benefit Plan
Design, Planning, and Negotiations.**

**Joyce A. Mader, Esq.
O'Donoghue & O'Donoghue, LLP**

An Overview of the Proposed Cafeteria Plan Regulations

- Proposed Regs issued August 6, 2007.
- Consolidate guidance issued over past 20 years.
- Generally, preserve existing guidance.
- Clarify some issues and include a few new rules.

What is a Cafeteria Plan?

- Code §125 permits employers/sponsors to offer employees to elect between certain “qualified” benefits and certain taxable benefits on a pre-tax basis.
- Exclusive means of offering such a choice.

Constructive Receipt

- If §125 rules are not followed, exercise of control itself makes full amount of benefit taxable...
- ...even if the benefit would otherwise be non-taxable.

Subjects in Regs

- Qualified and Non-Qualified Benefits
- Elections
- Flexible Spending Arrangements
- Substantiation of Expenses
- Non-Discrimination Rules

Written Plan

- Required.
- May be comprised of multiple documents.
- May be adopted or amended any time during plan year...
- ...but only effective for period after later of adoption or effective date.

Required Plan Provisions

- Prior guidance: description of all available benefits, period of coverage, participation and eligibility, election procedures, irrevocable status of elections, manner in which employer contributions are made, maximum amount of employer contributions.

Required Plan Provisions

New

- Statement of Uniformity to all participants.
- Definition of Employee
- Plan Year

Optional Plan Provisions

- Group term life insurance in excess of \$50,000.
- Coverage for non-spouse/non-dependent.
- Grace period.
- Run out period.
- Paid time off.

Prohibition of Deferred Compensation

- Consequences
- Benefits prohibition does not apply to.
- Permitted practices.
- Practices not permitted.

Qualified Benefits

- Group term life insurance up to \$50,000.
- Accident & health plans including FSAs.
- Payment or reimbursement of health insurance premiums.
- Certain COBRA premiums.
- AD&D insurance.
- Long-and short-term disability coverage.

Qualified Benefits

- Dependent care assistance.
- Adoption assistance.
- CODA/401(k).
- Plans of educational organizations to fund post-retirement group life insurance.
- Contributions to HAS.

Non-Qualified Benefits

- Scholarships
- Employer-provided meals and lodging.
- Educational assistance.
- Fringe benefits.
- Long-term care insurance or services.
- Non-employee group term life insurance.
- HRAs/Archer MSAs.
- §403(b) contributions.

Permitted Taxable Benefits

- Cash including--
 - Cash compensation including salary reduction.
 - Payments for leave or paid time off.
 - Severance pay.
- Taxable benefits treated as cash--
 - Property.
 - Benefits attributable to employer contributions that are currently taxable.
 - Benefits purchased with after-tax employee contributions.

Elections

- Timing—before earlier of first day of plan year or date taxable benefit would be currently available.
- Generally must be irrevocable.
Exceptions—new employees; HSAs
- May be automatic.
- Spouse of dependent may not make or change employee's election.

Flexible Spending Arrangements (FSAs)

- Largely restate previous proposed regs re FSAs.
 - Use it or lose it.
 - Uniform coverage rule.
 - FSA with HAS.
 - Dependent Care Assistance
 - FSA experience gains.

Substantiation of Expenses

- Regs emphasize that all reimbursements must be individually substantiated.
- Debit cards.

Non-Discrimination Rules

- Plan fails if it discriminates in favor of highly compensated individuals.
- Plan fails if key employees elect more than 25% of the aggregate elected benefits.
- Proposed regs provide
 - definitions of key terms
 - Guidance on “eligibility” test and “contributions and benefits” test.

Definitions

- “Highly compensated individual” – similar but not identical to HCE definition in §414(q).
- “Key employee” – as defined in §416(i)(1).

Test -- Eligibility

- Nondiscrimination in Eligibility
 - Incorporate “reasonable classification” test from §410(b).
 - Limited exclusions—
 - CBA employees (except key employees)
 - Non-resident aliens with no US source income
 - COBRA participants.

Test – Contributions and Benefits

- Plan does not discriminate if either do not discriminate in favor of highly compensated participants—
 - Qualified benefits and total benefits or
 - Employer contributions allocable to statutory nontaxable benefits and to total benefits
- Plan must meet this requirement for both benefit availability and benefit utilization.

Key Employee Concentration Test

- Applies if “key employees” in the aggregate receive more than 25% of statutory nontaxable benefits provided to all employees through plan.
- Impact only on key employees.

Safe Harbors

- Contributions based on cost of health plan coverage.
- Premium only plans that pass nondiscrimination test for eligibility.

Comments, Hearing and Effective Date

- Comments due November 5, 2007.
- Hearing on November 15, 2007.
- Effective Date: Plan Years beginning on or after January 1, 2009.
- New rule for determining taxable amount of group term life insurance over \$50,000 is effective August 6, 2007.