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New Cafeteria Plan Regulations

The IRS recently published new proposed regulations providing guidance on cafeteria plans (sometimes called "Section 125" plans). These proposed regulations withdraw other proposed regulations that had been published in 1984, 1989, 1997 and 2000. Even though the new regulations are not yet final, employers will want to review their cafeteria plans for compliance, since the IRS has said that employers can rely on the proposed regulations until final regulations are issued.

Highlights

- Code Section 125 is the exclusive means by which an employer can offer employees a choice between taxable and non-taxable benefits without the choice itself resulting in inclusion in gross income by the employees.
- A cafeteria plan is defined as a separate written plan that must describe all benefits, set forth the rules for eligibility to participate and the procedure for making elections, provide that all elections are irrevocable (except to the extent the plan includes the optional change in status rules), and state how employer contributions may be made under the plan, the maximum amount of elective contributions and the plan year.
- If the plan does not satisfy the requirements of Code Section 125 and the regulations, the plan is not a cafeteria plan. Some reasons a plan would fail to satisfy the cafeteria plan requirements include: offering nonqualified benefits; not offering an election between at least one permitted taxable benefit and at least one qualified benefit; failing to comply with the use-it-or-lose-it rule; allowing employees to revoke elections or make new elections; failing to comply with the substantiation requirements and failing to comply with the grace period rules.
- Former employees may participate in a cafeteria plan so long as the plan is not maintained predominantly for former employees.
- A cafeteria plan may provide for payment of COBRA premiums for an employee.
- A short plan year (or a change in plan year resulting in a short plan year) is permitted only for a valid business purpose.
- Cafeteria plans may provide an optional election for new employees between cash and qualified benefits. New employees avoid gross income inclusion if they make an election within 30 days after the date of hire even if benefits provided pursuant to the election relate back to the date of hire.
- Employers may reimburse a terminated employee's qualified dependent care expenses incurred after termination if all Code Section 129 requirements are otherwise satisfied.
- Experience gains (forfeitures) may be retained by the plan sponsor, may be used to defray expenses of administering the plan or may be allocated among employees contributing through salary reduction on a reasonable and uniform basis.
- All expenses must be substantiated. Substantiating only a limited number of total claims, or not substantiating claims below a certain dollar amount does not satisfy the proposed regulations.

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- Additional guidance is provided on the nondiscrimination rules, including definitions of key terms, guidance on the eligibility test and the contributions and benefits tests, descriptions of employees allowed to be excluded from testing and a safe harbor nondiscrimination test for premium-only plans.

If you have any questions regarding the new cafeteria plan proposed regulations, please contact a member of the Benefits Law Group.



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