Cafeteria Plan Developments

Presented by: Larry Grudzien

Attorney at Law

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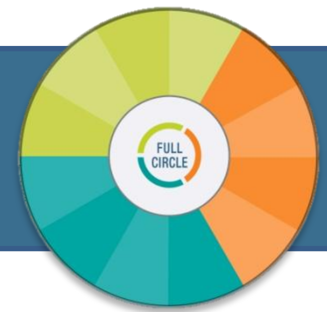

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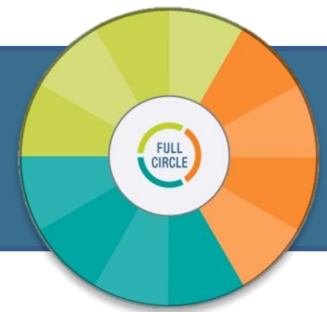
Agenda

- ✓ IRS Notice 2013-71
- ✓ IRS Notice 2013-54 & DOL Technical Release 2013-03
- ✓ Revenue Procedure 2013-35

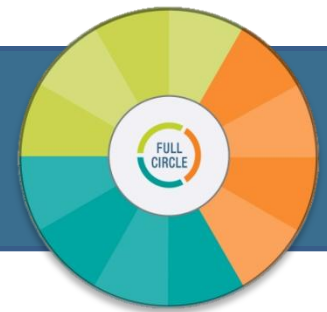
IRS Notice 2013-71

Introduction



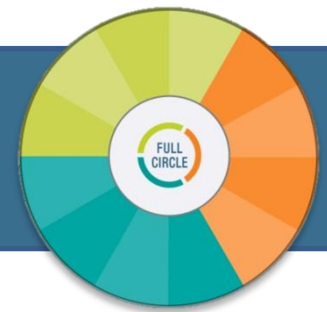
- On October 31, IRS and Treasury issued new guidance (Notice 2013-71) that modifies the “use or lose” rule that applies to health flexible spending arrangements (“FSAs”).
- Under the guidance, employers may now allow employees to carry over up to $500 of unused FSA balances to the next plan year.
- The Notice permits employers to adopt the carryover provision as early as the current 2013 plan year.
- The Notice also clarifies the transition relief provided in earlier proposed regulations so that employers of all sizes can permit certain changes in salary reduction elections for their non-calendar year cafeteria plan.

Background



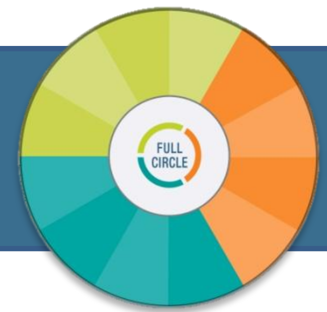
- Under the IRS' proposed regulations under Code 125, unused FSA balances at the end of a plan year cannot be used to reimburse expenses in the next plan year and must be forfeited.
- This "use or lose" rule was intended as a means of meeting the requirement under Code 125 that a cafeteria plan not provide for deferred compensation.
- An employer may, however, adopt a run-out period immediately following the end of the plan year in which the employee may submit claims for reimbursements incurred during the plan year.

Background



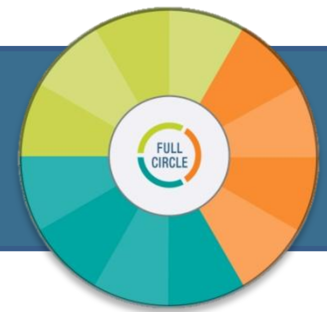
- In 2005, the IRS relaxed the use-or-lose rule and permitted employers to provide a grace period of up to 2 months and 15 days following the end of the plan year in which participants could continue to incur expenses and received reimbursements for those expenses from the unused amounts in the FSA at the end of the plan year.
- An employer adopting a grace period was also permitted to provide a run-out period after the end of the grace period.

Background



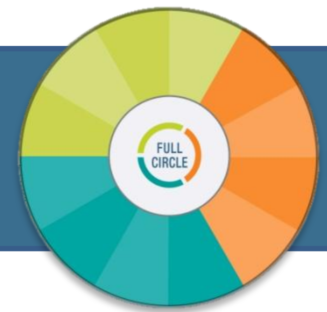
- Prior to the Affordable Care Act ("ACA"), there was no statutory limit on the amount of FSA salary reduction contributions that an employee could elect, although many employers imposed limits in the plan.
- The ACA limited the amount of salary reduction elections to an FSA to $2,500 per taxable year.
- In Notice 2012-40, the IRS recognized that the potential for using FSAs to defer compensation was restricted with the application of the limits on FSA salary reduction elections and requested comments on whether it should modify the use-or-lose rule.

Carryover of Unused FSA Balances



- **Permitted Carryover** – The Notice permits an employer to allow an employee to carryover up to $500 of any unused amount remaining in the FSA after the end of the run-out period to the next plan year.
- The carryover does not reduce the permitted $2,500 salary reduction election limit in the next plan year, and an employee with a carryover may still choose salary reduction elections for the next plan year of up to $2,500 (or other lower limit provided for in the plan).
- If the employer decides to allow a carryover, the same carryover limit must apply to all participants.

Carryover of Unused FSA Balances

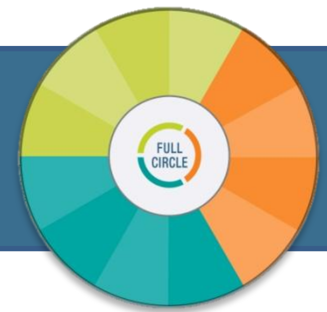


- **Permitted Reimbursements** – Consistent with the general cafeteria plan rules, the amount carried over may only be used to pay or reimburse permitted medical expenses.
- The carryover amounts may be used to reimburse expenses during the run-out period that were incurred during the previous plan year or may be used to reimburse expenses incurred in the current plan year.
- The salary reduction election in the current plan year, however, may only be used to reimburse expenses in the current plan year (unless carried over to the next plan year) and may not be used to reimburse expenses for the prior plan year during the run-out period.
- The Notice provides that for ease of administration, a plan is permitted (but not required) to treat reimbursements of all claims for expenses incurred in the current plan year as reimbursed first from the amounts credited from the current plan year and then as reimbursed from carried over amounts.

Carryover of Unused FSA Balances

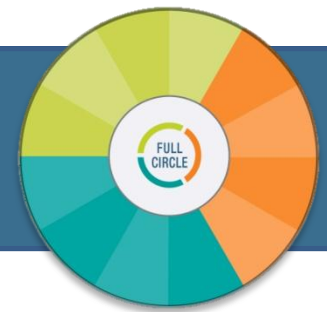
- The maximum amount of reimbursement must be available at all times during the period of coverage is still required for FSAs.

Carryover of Unused FSA Balances



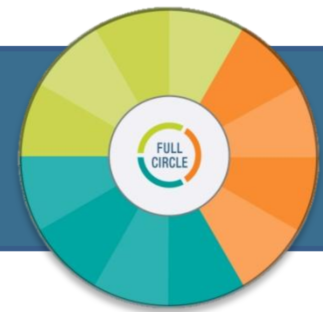
- **Removal of the Grace Period** – The Notice provides that a plan that adopts the carryover provision may not also provide a grace period for the FSA.
- An FSA may either provide for the carryover or provide for a grace period, but cannot provide for both.
- **Informing Participants** – The employer must inform participants of the carryover provision.
- Employers that adopt the carryover provision for the 2013 plan year should inform participants of both the new carryover feature and the removal of the grace period as soon as possible.

Cafeteria Plan Amendment



- **Timing of Amendment** – An employer has until the last day of the plan year from which amounts may be carried over to amend its cafeteria plan to adopt the new carryover option, and the amendment may be retroactive to the first day of that plan year.

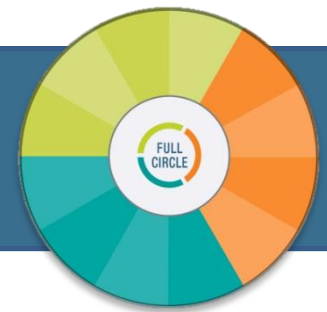
Cafeteria Plan Amendment



- **Special Rule for 2013 Plan Years** –Recognizing that for many plans, employers would only have a few months to amend their cafeteria plans for the 2013 plan year, the Notice contains a special rule for the 2013 plan year that permits an employer to amend its cafeteria plan to adopt the carryover provision for a plan year that begins in 2013 at any time on or before the last day of the plan year that begins in 2014.

- For a calendar year plan, this means that an employer could amend its cafeteria plan as late as December 31, 2014 to adopt a carryover from the 2013 plan year to the 2014 plan year.

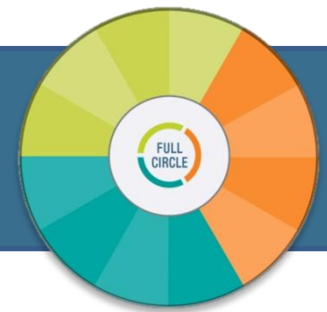
Cafeteria Plan Amendment



- **Grace Period Amendment** – An employer adopting the carryover must also amend its cafeteria plan to remove the grace period no later than the end of the plan year from which amounts may be carried over.

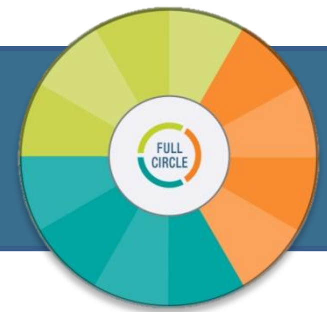
- An employer with a calendar year cafeteria plan that provides a grace period that wishes to adopt the carryover for the 2013 plan year should amend its cafeteria plan to eliminate the grace period and provide for the carryover before the end of the 2013 plan year.

FSA & HSA



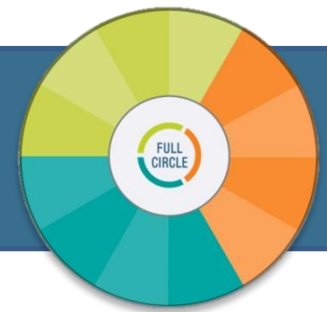
- The ability for an employer to provide for a carryover and also permit employees newly eligible for a health saving account ("HSA") to contribute to the HSA is uncertain.
- Generally, an individual who is covered by a general purpose FSA may not make contributions to an HSA.
- However, an individual may be covered under certain types of FSAs, such as a limited purpose FSA that pays or reimburses expenses only for preventive care and certain "permitted coverage" or a post-deductible FSA that pays or reimburses preventive care and other permitted medical expenses only if incurred after the minimum annual deductible for the high deductible health plan is satisfied.

Cafeteria Plan Salary Reduction Election Transition Rule



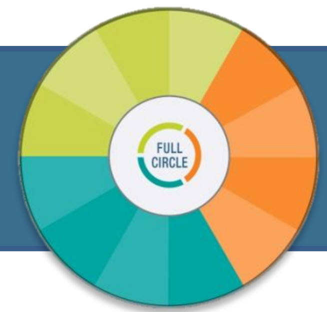
- Cafeteria plan elections must be made before the start of the plan year and are irrevocable during the plan year unless the employee or his/her spouse or dependents experience certain qualifying events.
- The availability of health coverage through an Exchange is not a permitted change in status, and thus, employees generally cannot change their salary reduction elections for health coverage to cease salary reductions and purchase coverage through an Exchange.
- Similarly, employees generally cannot elect to begin salary reduction elections mid-year to purchase the employer's health coverage and avoid the individual mandate penalty.
- This is a concern for non-calendar year cafeteria plans because individuals can begin purchasing Exchange coverage effective January 1, 2014 and the individual mandate penalty applies beginning in January 2014.

Cafeteria Plan Salary Reduction Election Transition Rule



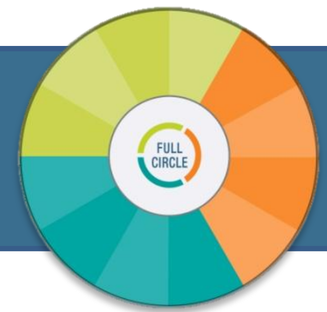
- The IRS provided transition relief from the cafeteria plan election rules for an employer-provided accident and health plan with a non-calendar year plan year that begins in 2013.
- Under this transition relief, an employer can amend its cafeteria plan to permit employees to make the following changes in salary reduction elections, even if the employee did not experience a change in status event:
  - if the employee elected to salary reduce for accident and health plan coverage, prospectively revoke or change his/her election with respect to the accident and health plan once during that plan year; and
  - if the employee failed to make a salary reduction election, make a prospective salary reduction election for accident and health coverage on or after the first day of the 2013 plan year.

Cafeteria Plan Salary Reduction Election Transition Rule



- The Notice clarifies that this transition relief is available to all employers and is not limited to applicable large employers.
- The Notice also clarifies that employers may adopt amendments that are more restrictive than the two options in the transition relief, but the amendment may not be less restrictive.
- For example, the employer may limit the period that the employee can make the salary reduction election change to a certain time period, such as the first month in 2014, instead of during the entire 2013 – 2014 plan year.

Unanswered Questions



- ✓ Can employers with plan years ending in 2013 after the Notice is released take advantage of the rollover?
- ✓ Can the rollover be automatic or can an employer give employees an election not to rollover?
- ✓ Can an employer keep the grace period for the dependent care FSA?

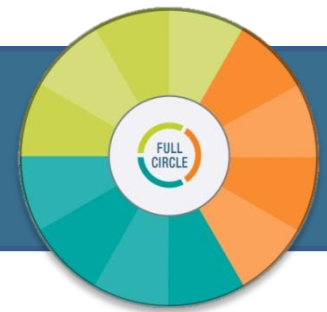
Unanswered Questions

- ✓ Can amounts be rollover for a period of more than one year?
- ✓ Can the amounts rollover switch from general purpose to limited purpose?
- ✓ Can an employer give an employee an election to switch?

Unanswered Questions

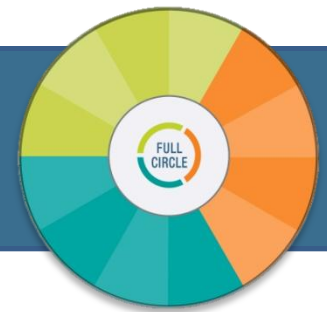
- ✓ If an employee terminates, can he or she take advantage of the rollover amounts?
- ✓ To take advantage of the rolled over amount, does the employee have to elect COBRA?
- ✓ If that is true, how does an employer determine the premium for the rolled over amount?

Employer Next Steps



- Employers now have a choice whether to adopt a carryover feature, a grace period feature or a traditional health FSA with no such feature.
- This is a matter of plan design and not employee choice.
- Employers should decide whether to amend their plans to allow for the permitted carryover of unused health FSA amounts, and timely amend plan documents and communicate to participants as necessary.
- Employers offering health FSAs containing a grace period and electing to allow carryover of unused health FSA amounts should amend their plans to remove the grace period as necessary and communicate the change to participants.
- In addition, employers that offer high-deductible health plans (HDHPs) with HSA features will need to assess how adoption of a health FSA carryover feature affects an individual or employer's eligibility to make HSA contributions.

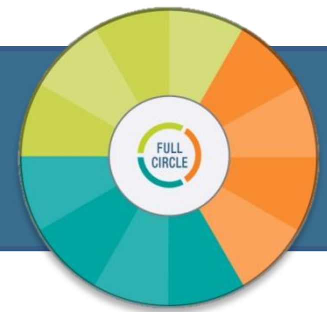
Employer Next Steps



- ✓ There are pros and cons for employers to consider in adopting the carryover feature and eliminating a grace-period feature.
- ✓ For example, participants with year-end balances greater than $500 may benefit from a grace period feature that contains no cap but has a shorter duration for incurring and submitting claims, while participants with year-end balances of $500 or less may benefit from having a longer duration to submit and incur claims.
- ✓ If an employer sponsors a HDHP with an HSA feature, consideration also must be given to how the grace period and carryover features affect an individual's eligibility to make and receive HSA contributions.
- ✓ It may also be impractical for an employer to remove a grace period feature for the 2013 or 2014 plan year that has already been communicated to employee.

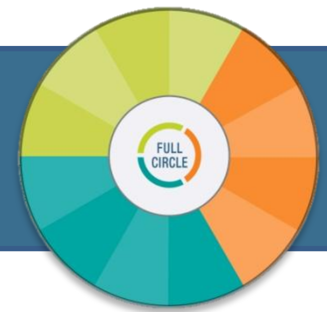
IRS Notice 2013-54 & DOL Technical Release 2013-13

Introduction



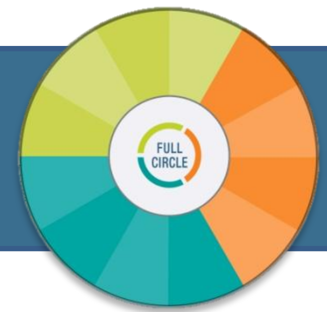
- The two pieces of guidance are substantially identical and address many previously unanswered questions regarding how market reform and other provisions of the Affordable Care Act (Act) apply to health reimbursement arrangements (HRAs), including HRAs integrated with group health plans; health flexible spending arrangements (health FSAs); and employee assistance programs (EAPs).
- The following series of questions and answers will review how these two pieces of guidance affect premium only plans (POPs) and health FSAs only in 2014.

Q&As



Q-1. In 2014, can an employer allow employees to pre-tax premiums for medical coverage's on the individual market purchased either inside or outside the public exchanges (marketplace)?

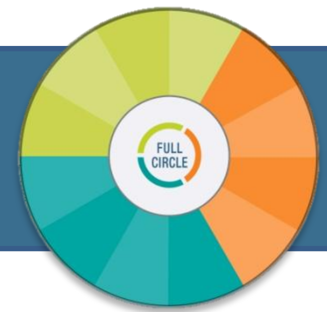
Q&As



A-1. No. Code 125(f)(3), has been amended effective for taxable years beginning in 2014 to prohibit employees from purchasing medical coverage in the individual market through a public Exchange on a pre-tax basis using the employer's cafeteria plan (but, employees may still purchase coverage on a SHOP Exchange on a pre-tax basis using the employer's cafeteria plan if the employer offers SHOP coverage to its employees).

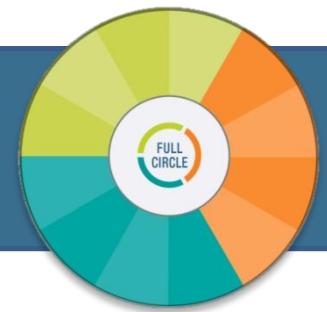
- The SHOP Exchange, (the SHOP Marketplace or Small Business Health Options Program), is a section of the health insurance marketplace where small employers can purchase employee group health insurance.

Q&As



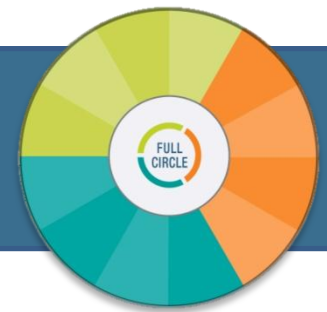
- For any medical coverage purchased outside of the Exchange in the individual market, any pre-tax reimbursement of individual market medical premiums under a POP would constitute an "employer payment plan" and would be disallowed.

Q&As



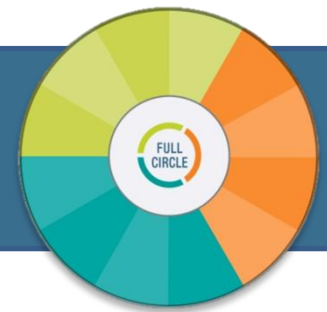
- Code 125 merely provides for the non-taxability of the choice between cash and pre-tax benefits. Code 125 does not provide the actual exclusion from employee income for employer-provided medical coverage.
- That exclusion is reserved exclusively under Code 106.
- For tax (but not ERISA) purposes, amounts deducted from employees' pay under a cafeteria plan election are treated as employer contributions.
- This is so because employee deferrals are made under a salary reduction agreement-the employee agrees to a reduction in salary in a specified amount and the employer agrees to contribute a like amount toward the purchase of qualified benefits (medical coverage, in this instance).

Q&As



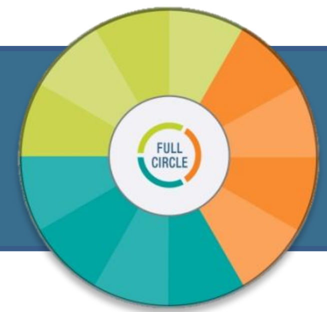
- Any employee pre-tax contributions to a POP will be treated as employer funds and payment of a premium by the employer with those funds (which are excluded from the employee's gross income under Code 106) essentially becomes an "employer payment plan."
- Employer payment plans for coverage in the individual market fail Q&A-1 in Part III of IRS Notice 2013-54.
- This guidance provides that any employer payment plan, that reimburses employees for an employee's substantiated individual market insurance policy premiums must satisfy the market reforms for group health plans.

Q&As



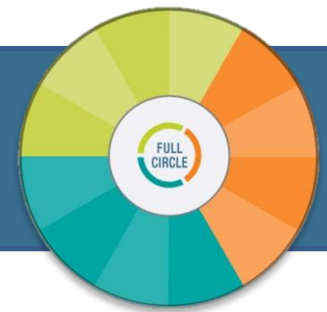
- However, the employer payment plan will fail to comply with the annual dollar limit prohibition because:
  - an employer payment plan is considered to impose an annual limit up to the cost of the individual market coverage purchased through the arrangement, and
  - an employer payment plan cannot be integrated with any individual health insurance policy purchased under the arrangement.

Q&As



Q-2. Can an employee be reimbursed on a pre-tax basis under a POP for premiums in the individual market for benefits other than medical coverage?

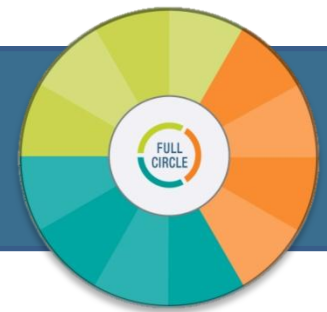
Q&As



A-2. Yes. The above restrictions only apply to individual market medical coverage.

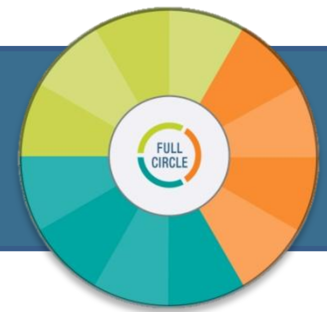
- Under Proposed Treasury Regulations 1.125-1(m)(1), it is possible to pre-tax premiums for dental, vision, disability, accidental death and dismemberment (AD&D), cancer insurance, hospital indemnity, and supplemental life insurance coverage in the individual market, to name just a few.
- Please remember making a cafeteria plan available for policies in the individual market (or paying for any portion of the premiums) raises issues under the Internal Revenue HIPAA, ERISA, COBRA, and other laws.

Q&As



Q-3. Which health FSAs are not subject to the Act and the market reforms in 2014?

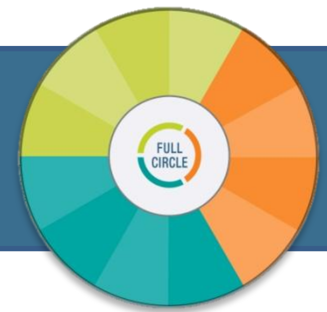
Q&As



- IRS Notice makes clear that the Act's market reform requirements do not apply to health FSAs that meet the "excepted benefit" definition.

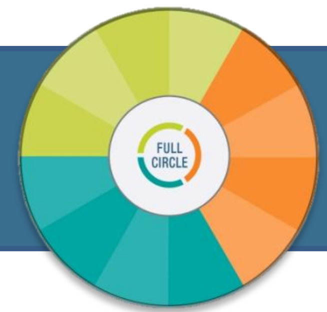
- A health FSA is considered an excepted benefit for a "class of participants" if the health FSA is a health FSA under Code 106(c)(2) and satisfies two conditions.

Q&As



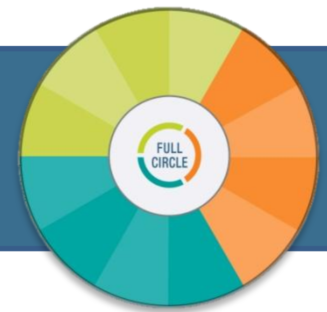
- **Maximum Benefit Condition**: The maximum benefit payable under the health FSA to any participant in the class for a year cannot exceed two times the employee's salary reduction election under the health FSA for the year (or, if greater, the amount of the employee's salary reduction election for the health FSA for the year, plus $500), as provided in Treasury Regulations 54.9831-1(c)(3)(v)(B); DOL Regulations 2590.732(c)(3)(v)(B); and HHS Regulations 146.145(c)(3)(v)(B); and
- **Availability Condition**: Other nonexcepted group health plan coverage (e.g., major medical coverage) must be made available for the year to the class of participants by reason of their employment, as provided in Treasury Regulations 54.9831-1(c)(3)(v)(A); DOL Regulations 2590.732(c)(3)(v)(A); and HHS Regulations 146.145(c)(3)(v)(A).

Q&As



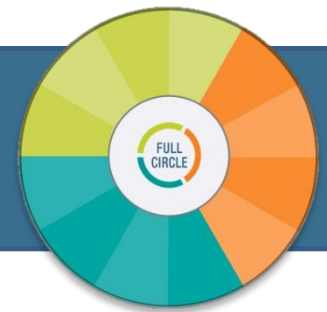
- **Examples of Health FSA Funding That Meet the Maximum Benefit Condition:**
  - A one-for-one employer match (employer $600, employee $600).
  - An employer contribution of $500 or less (employer $500, employee $200).
- **Examples of Health FSA Funding That Do Not Meet the Maximum Benefit Condition:**
  - An employer contribution of more than $500, if the employee contributes $500 or less (employer $600, employee $400).
  - An employer contribution in excess of a one-to-one match, if the employee contributes more than $500 (employer contributes $700, employee contributes $600).

Q&As



Q-4. In 2014, can an employer still offer a stand-alone Health FSA?

Q&As



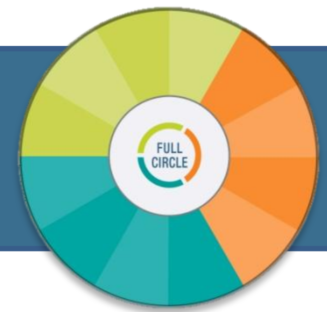
A-4. Yes, so long as the stand-alone health FSA qualifies as HIPAA-excepted.

- For a stand-alone health FSA to be considered to provide only excepted benefits, it must meet one of the following designs:
  - Limited scope dental and vision benefits that are not an integral part of a group health plan are excepted benefits.
  - If other group health plan coverage not limited to excepted benefits is made available for the year to employees by the employer, and the FSA is structured so that the maximum benefit payable to any participant cannot exceed two times the participant's salary reduction election for the arrangement for the year (or, if greater, cannot exceed $500 plus the amount of the participant's salary reduction election).

Q&As

Q-5. If a health FSA is considered to be a non-excepted benefit, what are the consequences?

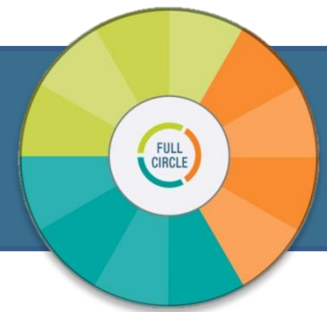
Q&As



A-5. A health FSA that does not qualify as an excepted benefit is generally subject to the Act's market reforms, including the preventive services requirements, unless it is grandfathered.

- The IRS and DOL had previously ruled that a health FSA is not subject to the annual dollar limit prohibition, irrespective of whether the health FSA provides only excepted benefits.
- Because a health FSA that is not an excepted benefit is not integrated with a group health plan, it will fail to meet the preventive services requirements, unless it is grandfathered.
- For failure to meet the Act's market reforms, an employer could also be subject to fines and penalties.

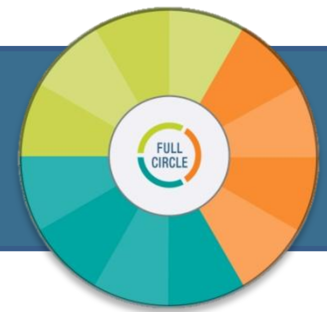
Employer Next Steps



- As the clock ticks down to January 1, 2014, employers offering any type of account-balance health plan – or reimbursing their employees for any health insurance premiums – will want to review those arrangements to determine whether they are subject to the ACA and, if so, whether they comply with the market reforms.
- If they do not comply, prompt action should be taken to amend or terminate the arrangements, and to communicate the changes to employees.
- It may even make sense to split a single plan into active-employee and retiree-only plans, thereby preserving greater flexibility with respect to retirees

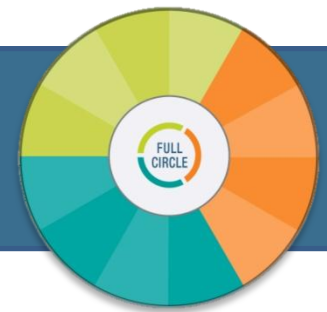
Revenue Procedure 2013-35

Annual Inflation Adjustments



- The annual dollar limit on employee contributions to employer-sponsored healthcare flexible spending arrangements (FSA) remains unchanged at $2,500.
- The amount for the adoption credit or the amount excluded for adoption assistance allowed for an adoption of a child with special needs is $13,190.
- The dollar amount for employee health Insurance expense of small employers is $25,400. (Small Employer Business Tax Credit)
- The monthly limitation for qualified transportation fringe benefit regarding the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass is $130.
- The monthly limitation regarding the fringe benefit exclusion amount for qualified parking is $250.

Annual Inflation Adjustments



The limitations regarding eligible long-term care premiums includible in the term "medical care," are as follows:

Attained Age Before the Close of the Taxable Year	Limitation on Premiums
– 40 or less	$370
– More than 40 but not more than 50	$700
– More than 50 but not more than 60	$1,400
– More than 60 but not more than 70	$3,720
– More than 70	$4,660

- For Medical Savings Accounts, the term "high deductible health plan" means, for self-only coverage, a health plan that has an annual deductible that is not less than $2,200 and not more than $3,250, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $4,350.
- For Medical Savings Accounts, the term "high deductible health plan" means, for family coverage, a health plan that has an annual deductible that is not less than $4,350 and not more than $6,550, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $8,000.

Questions

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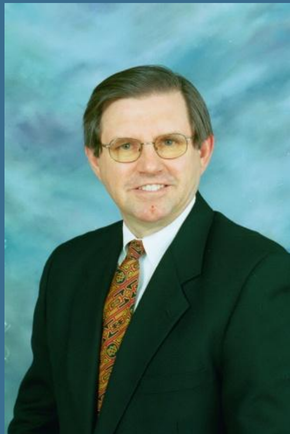

Contact Larry Grudzien

708.717.9638
larry@larrygrudzien.com
www.larrygrudzien.com

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