

Section 125 Plans: Employers to Review New Regulations

This past August, the IRS issued the most comprehensive revisions to rules governing cafeteria plans in two decades. The proposed 124 pages update, organize, and consolidate the agency's previous regulations and guidance, explains Susan Relland, attorney with Miller & Chevalier in Washington, D.C.

Although the rules won't be finalized until sometime next year for plans taking effect on or after Jan. 1, 2009, legal experts strongly urge employers to begin examining their plans and documents now to make sure they will be in compliance when that day comes. The IRS advises that employers rely on the new rules now.

"The bottom line, however, is that these proposed regulations are going to require everybody to look again at their documents," cautions Frank Palmieri, partner, Palmieri & Eisenberg in Princeton, N.J. Regardless of the complexity of the plan, all employers who offer a Section 125 plan must comply with certain provisions in the establishment and operation of the plan in order to ensure the validity of the plan's tax-preferred status, according to Milliman's Penny Plante and Donald Sims.

Relland also notes that the strict tone of the proposed rules indicates that the IRS plans to take a much tougher enforcement stance on compliance from now on. According to Josh Norris, attorney with Fisher & Phillips LLP in Atlanta, failure to comply with the rules will result in a disqualification of the employer's cafeteria plan – which means the employee's entire election would be included in gross income, regardless of whether he or she elected taxable or nontaxable benefits.

According to Milliman and Fisher & Phillips, the following items highlight the most significant features of the new regs:

1. Clarification of the eligibility definition
2. Explanation/description of benefits that can/must be offered
3. Written plan documents
4. Calculation of imputed income from life insurance to come from one table (Table 1) only
5. Change plan year only for a valid business purpose
6. Irrevocable employee elections (electronic and automatic)
7. Grace period extends access to money in FSAs an extra two-and-a-half months
8. Substantiation of all expenses
9. Timing of discrimination testing

Employers who have been following the updates to the regulations over the years will find they have very little to do at this point. However, an audit of one's cafeteria plan should reveal any fine-tuning needed. Source: HRInsider 12/2007 ■

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