

## Section §125 Cafeteria Plan, DOL & ERISA Compliance Self Audit

Recent announcements by the IRS and DOL have indicated a “**zero tolerance compliance standard**” for adherence to required published guidelines. Many employers are routinely **ignoring** IRS and DOL compliance requirements for properly establishing and maintaining IRS Section 125 plans to deduct insurance premiums, medical and dependent care expenses. If the employer is audited and the plan disqualified, there could be serious repercussions such as **1.) deductions may be disallowed back to inception**, **2.) assessment of back taxes with interest**, **3.) IRS ‘improper withholding’ penalties** and, **4.) daily DOL fines**. The employer would then be required to reissue W-2’s for every participant possibly for multiple years and each employee could be faced with a large tax bill. Internal Revenue Code Section §125 Cafeteria Plan governs:

Type of Section §125 Cafeteria Plan	Funded by:	Purpose:
<ul style="list-style-type: none"> <li><b>POP (Premium Only Plan) AKA Pre-Tax Premium Plan</b></li> </ul>	Employee	Pre-tax premiums for accident, health and limited group term life insurance
<ul style="list-style-type: none"> <li><b>FSA (Flexible Spending Account)</b></li> </ul>	Employee and/or Employer	Reimbursement Accounts for permitted Medical and/or Dependent Care Expenses
<ul style="list-style-type: none"> <li><b>HRA (Healthcare Reimbursement Account)</b></li> </ul>	Employer	Reimbursement Account for permitted Medical Expenses
<ul style="list-style-type: none"> <li><b>HSA (Healthcare Savings Account)</b></li> </ul>	Employee and/or Employer	Reimbursement Account for permitted Medical Expenses

Although these are not inclusive of all requirements, please check below to determine your plan compliance:

		Yes	No
☒	<p><b>1 Do you have a written Section §125 Cafeteria Plan document?</b></p> <p>§1.125.1 “Q-2: What is a "cafeteria plan" under section 125? A-2: A "cafeteria plan" is <b><u>a separate written benefit plan</u></b> maintained by an employer for the benefit of its employees, under which all participants are employees and each participant has the opportunity to select the particular benefits that he desires. 125(d)(1) <b><u>requires that a cafeteria plan be in writing.</u></b>”</p>	<input type="checkbox"/>	<input type="checkbox"/>
☒	<p><b>2 Does your plan satisfy the requirements of section 125 and the regulations?</b></p> <p>Qualified &amp; nonqualified benefits in cafeteria plans: <b><u>Reasons that a plan would fail to satisfy the section 125 requirements include:</u></b> offering nonqualified benefits; not offering an election between at least one permitted taxable benefit and at least one qualified benefit; deferring compensation; failing to comply with the uniform coverage rule or use-or-lose rule; allowing employees to revoke elections or make new elections during a plan year, except as provided in §1.125-4; failing to comply with substantiation requirements; paying or reimbursing expenses incurred for qualified benefits before the effective date of the cafeteria plan or before a period of coverage; allocating experience gains (forfeitures) other than as expressly allowed in the new proposed regulations; and failing to comply with grace period rules.</p>	<input type="checkbox"/>	<input type="checkbox"/>
☒	<p><b>3 Does your plan operate in accordance with the written plan terms?</b></p> <p>Section 125(d)(1) The cafeteria plan <b><u>must be operated in accordance with the written plan terms.</u></b> The new proposed regulations require that the written plan specifically describe all benefits, set forth the rules for eligibility to participate and the procedure for making elections. Employers who adopt a <b><u>2 ½ months “grace period”</u></b> must document and formally adopt the provision as part of the plan prior to the start of the plan year. Particulars regarding the eligibility of an expense inclusive of the use of <b><u>debit cards</u></b> should be spelled out.</p>	<input type="checkbox"/>	<input type="checkbox"/>
☒	<p><b>4 Do you distribute a Summary Plan Description or SPD to all employees?</b></p> <p>Employers are <b><u>required</u></b> by the Department of Labor to distribute a Summary Plan Description to every employee initially and at predetermined intervals and at least once every 5 years.</p>	<input type="checkbox"/>	<input type="checkbox"/>

☒	Yes	No
<p><b>5 Do you collect annual, signed, salary reduction election forms from all employees?</b></p> <p>§1.125-2 – Making, revoking and changing elections – “Generally, a cafeteria plan <b><u>must require employees to elect annually</u></b> between taxable benefits and qualified benefits.” Annual, signed, salary reduction election forms should be kept on file and available for review or audit. IRS: “How does a cafeteria plan work? Employer contributions to the cafeteria plan are usually made pursuant to <b><u>salary reduction agreements between the employer and the employee</u></b> in which the employee agrees to contribute a portion of his or her salary on a pre-tax basis to pay for the qualified benefits.” <a href="http://www.irs.gov/govt/fslg/article/0,,id=112720,00.html">http://www.irs.gov/govt/fslg/article/0,,id=112720,00.html</a></p>	<input type="checkbox"/>	<input type="checkbox"/>
<p><b>6 Do you assume that employees may be automatically enrolled w/o a signed election form?</b></p> <p>An election plan design may satisfy the IRS regulations, but administrators need to be sure that their <b><u>plan documents are consistent with those regulations</u></b>. (EBIA on §1.125-4 01/2002) §1.125-1 “The written cafeteria plan must contain ... (iii) <b><u>The procedures governing employees' elections</u></b> under the plan,” “A cafeteria plan is <b><u>permitted to include an automatic election for new employees or current employees</u></b>. Rev. Rul. 2002-27 (2002-1 CB 925), see §601.601(d)(2)(ii)(b). <b><u>There are certain notice obligations that are required prior to implementing an automatic election process. Signed declination forms must be collected.</u></b></p>	<input type="checkbox"/>	<input type="checkbox"/>
<p><b>7 Do you obtain employees' written consent before withholding for health plan benefits?</b></p> <p>ERISA preempts state law <b><u>requiring employers to obtain employees' written consent</u></b> before withholding for health plan benefits.</p>	<input type="checkbox"/>	<input type="checkbox"/>
<p><b>8 Do you update and maintain your plan document for new IRS provisions and laws?</b></p> <p>Failure to update and maintain the plan document for new IRS provisions and laws regarding COBRA, HIPAA, FMLA, USERRA, protected health information, over-the-counter prescription drugs, new definitions for dependents, deductions for domestic partners, mid-year qualifying events to make election changes <b><u>may disqualify the plan altogether</u></b>. Employers with outdated plan materials often <b><u>inadvertently create contractual obligations to participants</u></b>, even where the employer may be satisfying federal requirements.</p>	<input type="checkbox"/>	<input type="checkbox"/>
<p><b>9 Do you apply Discrimination Testing annually on the last day of the plan year?</b></p> <p><b><u>Discrimination testing is required annually on the last day of the plan year</u></b> and proof of testing should be available for possible IRS audit. Safe Harbor for Premium-Only Plans. <b><u>Discrimination includes:</u></b> __Reimbursing medical and insurance expenses to only certain key employees, __Discriminating within a class of employee, __Basing benefit limits for reimbursement on seniority or a percentage of pay, __Highly compensated and key employee deductions total more than 25% of group deductions, __Professional groups, normally physicians, setting up elaborate insurance and medical expense reimbursement schemes without a formal plan while excluding hourly employees.</p>	<input type="checkbox"/>	<input type="checkbox"/>
<p><b>10 Does your plan violate any prohibited acts?</b></p> <p><b><u>Prohibited acts include:</u></b> __Failure to enforce twelve month irrevocable deduction rules during the plan year, __Refunding unused funds back to the employee from medical and dependent care assistance FSA plans at the end of the plan year, __S Corporation owners and family members pre-taxing benefits, __Owners participating illegally, __Pre-taxing health savings account bank funds through the Section 125 Premium Only Plan without proper plan documentation addressing HSA administration, __Not limiting Medical Expense Reimbursement FSA plans offered in combination with HSA plans.</p>	<input type="checkbox"/>	<input type="checkbox"/>