

LEGAL ALERT

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TIME IS RUNNING OUT TO AMEND CAFETERIA PLANS

By Ann-Mary Petroskey, Attorney

An IRS notice issued in May has provided relief from the “use it or lose it” rule applicable to §125 cafeteria plans. Under proposed regulations issued in the 1980s, cafeteria plan participants have been prohibited from using contributions made during a plan year to purchase benefits in a subsequent plan year. The proposed regulations required the unused contributions or benefits remaining at the end of the plan year to be forfeited and have been a source of frustration for many employers and employees.

Responding to increased public and Congressional pressure, the IRS modified the cafeteria plan rules to permit contributions made during a plan year to be used to reimburse expenses incurred during a grace period of two and one half months following the end of the plan year. The new rules require that company plans be amended by the end of 2005 in order to take advantage of this additional grace period.

For example, suppose an employee made a contribution of \$1,000 to his health flexible spending account for the plan year ending December 31, 2005, and has \$200 remaining in his account at the end of the year. The employee could use the \$200 to reimburse medical expenses incurred from January 1, 2006 through March 15, 2006. So, if the employee incurred a \$150 expense on March 1, 2006, the employee could apply the unused balance from the 2005 plan year to reimburse the expense. If the employee does not use the remaining \$50 by March 15, 2006, it would be forfeited.

Employers wishing to take advantage of the grace period should be aware of the following:

Plan Amendment Required. The relief is available only if plan documents are amended to allow for the grace period. An employer may adopt a grace period for the current plan year and future plan years by amending the cafeteria plan document by the end of the current plan year.

Contributions Cannot be Converted to Other Benefits. A cafeteria plan may not permit unused benefits or contributions to be cashed out or converted to other taxable or non-taxable benefits during the grace period. Unused contributions relating to a particular benefit during the plan year may only be used to reimburse expenses for the same qualified benefit incurred during the grace period. For example, a participant could not apply unused health flexible spending account contributions to reimburse dependent care expenses incurred during the grace period.

Use it or Lose it Rule Still Applies. At the end of the grace period, the use it or lose it rule continues to apply to any unused contributions.

Run Out Period Still Allowed. The plan may allow a run-out period following the grace period during which participants may apply for reimbursements of expenses incurred during the plan year and grace period.

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DON'T FORGET ABOUT THE HIPAA SECURITY RULE!

By Ashley W. Taylor, Attorney

As you begin to revise your health and cafeteria plan documents to ensure compliance with the IRS, don't forget about HIPAA! The Health Insurance Portability and Accountability Act of 1996 (HIPAA) also imposes new requirements on group health plans under its security regulations.

The security regulations apply to all "covered entities," which includes group health plans and flexible spending accounts. Unlike the privacy regulations, the security regulations apply only to "Electronic Protected Health Information" (EPHI). Under HIPAA, plan documents must be amended to provide that the sponsor of each plan will appropriately protect any EPHI that it creates, receives, maintains or transmits on behalf of the plan. The amended documents must provide that the plan sponsor will:

- Implement administrative, physical and technical safeguards that protect the confidentiality, integrity and availability of EPHI.
- Ensure that there is adequate separate between the group health plan and the plan sponsor.
- Ensure that any agent, including a subcontractor, to whom it provides EPHI agrees to similarly protect the EPHI; and
- Report to the group health plan any attempted or successful unauthorized use, disclosure, modification or destruction of EPHI of which it becomes aware.

In addition to making the above amendments to the plan documents, a group health plan must also comply with all of the other requirements under the Security Rule, including conducting a risk analysis to assess the risks and vulnerabilities to the confidentiality, integrity and availability of its EPHI. This analysis should provide the plan with the information it needs to select and implement the appropriate safeguards required under the rule to reduce the identified risks and vulnerabilities to an acceptable level.

While large health plans had to be in compliance with the security regulations by April 20, 2005, "small health plans" are given an extra year to comply and have until April 2006. A "small health plan" is a health plan with annual receipts of \$5 million or less. To determine its annual receipts, a fully insured health plan should use the amount of total premiums it paid for health insurance benefits during the plan's last full fiscal year. A self-insured plan, funded or unfunded, should use the total amount paid for health care claims by the employer during the plan's last full fiscal year.

If you would like any assistance in amending your plan documents or complying with HIPAA, please feel free to contact Ashley Taylor at ataylor@shrr.com or 734.913.6907.