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Recent Cafeteria Plan Changes:

Your cafeteria plan may need updating for recent legal changes, particularly in light of 124 pages of IRS regulations issued on August 3, 2007. The regulations are too complex to fully summarize in this short note, but highlights include:

- (1) The new IRS regulations specify what needs to be in the **written plan document**, including:
 - Description of benefits
 - Eligibility rules
 - Procedure for making irrevocable elections
 - Change in status events
 - State how contributions are made to plan
 - Maximum amount of elective contributions
 - Plan year
 - Uniform coverage and use-or-lose rules if FSA
 - Specify that only employees may participate
 - Grace period must be written if adopted
 - All provisions must apply uniformly for all participants
- (2) The new IRS regulations specify a **method of imputing income** for group-term life insurance offered through a cafeteria plan. The method may be different than the one used by your Payroll Department or Payroll service provider. **This change is immediately effective, so prompt attention is suggested.**
- (3) The new IRS regulations have formalized the **discrimination tests** that must be performed annually to demonstrate that the cafeteria plan benefits do not

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discriminate in favor of your highly compensated employees. The discrimination rules reflect a modification, clarification and formalization of a hodge-podge of discrimination rules that have applied to cafeteria plans and constituent plans (medical under 105(h), group life, dependent care, etc.) for decades. This hodge-podge was often overlooked. With the new regulations, we expect that **IRS will be more likely to audit and enforce** the cafeteria plan discrimination rules.

- (4) The new IRS regulations make it clear that **non-compliance** with the written plan document requirement or the operational compliance requirements, including the nondiscrimination rules, **will result in income inclusion** for Federal income and employment tax purposes.
- (5) The general **effective date** for these regulations is for plan years beginning on or after January 1, 2009. However, some of the changes are effective sooner (for example, the change in imputing income for group-term life insurance is effective in 2007.)

Please let us know if you would like us to review your cafeteria plan document, related payroll procedures, or discrimination testing for compliance with the new regulations.