

Important Changes Relating to Section 125 Plans May Require Immediate Action

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Last week, there were two important developments relating to Section 125 cafeteria plans. First, Massachusetts announced that employers will no longer be required to maintain a Section 125 plan. Second, the IRS has modified the “use or lose” rule relating to Flexible Spending Arrangements (FSAs) under Section 125 plans. These new rules may warrant immediate changes to employers’ Section 125 plans.

1. Massachusetts Eliminates Section 125 Plan Requirement

Under the Massachusetts health care reform law, an employer with 11 or more Massachusetts-based employees was required to offer a cafeteria plan, so that all employees, including those not benefits eligible, could purchase health insurance using pre-tax dollars. In response, many employers adopted premium-only Section 125 plans or amended their existing plans in order to enable employees to purchase health insurance through the Connector, the state health insurance exchange. On October 28, 2013, the Connector issued an administrative bulletin, announcing that it would no longer enforce the Section 125 requirement and that it would be seeking its repeal.

The impetus for this change is that the U.S. Department of Labor and the Internal Revenue Service issued guidance under the Affordable Care Act that for plan years beginning in 2014, employers will not be able to offer Section 125 plans to employees for the purchase of non-group health insurance, such as from the Connector, using pre-tax income. Massachusetts employers may need to terminate their premium-only plans or amend their Section 125 plans before the beginning of the 2014 plan year. Note that employers may continue to offer Section 125 plans for other purposes, such as the purchase of group health insurance or other benefits.

2. Changes to the “Use or Lose” Rule for FSAs

Last week, the IRS issued guidance modifying the “use-or-lose” rule. Under that rule, amounts credited to an employee’s health FSA account that remained unused after the plan year plus a grace period of up to two and half months were forfeited. According to the new guidance, employers may amend their Section 125 plans to allow employees to carryover up to \$500 to the next immediate plan year. That carryover amount may be used to pay or reimburse medical expenses incurred during the next plan year. However, an employer that chooses to incorporate the new carryover rule may not also provide for a grace period for employees to use amounts after the end of the plan year. Employers who wish to amend their Section 125 plans to adopt the carryover provision will need to think about the timing of such change and ensure that participants are given appropriate notice, particularly if the employer is replacing the permitted grace period with the carryover provision.

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