



# Legislative Brief

## Treasury, IRS Issue New Proposed Cafeteria Plan Regulations



On August 3, 2007, the Treasury Department and the IRS issued new proposed regulations for employee benefit plans under Section 125 of the Internal Revenue Code. The plans, called "cafeteria plans," allow employees to make a choice between receiving taxable cash compensation or tax-free employee benefits, such as health care, dependent care, and other fringe benefits.

The new proposed regulations generally preserve the rules of the existing proposed regulations, while adding clarifications relating to statutory changes and administrative guidance changes since the previous regulations were published. The new regulations also address many issues on which the IRS has previously provided informal guidance.

The proposed regulations will assist employers, employees, and plan administrators in utilizing cafeteria plans.

The new proposed regulations:

- Clarify that cafeteria plans are generally the sole method of preserving the nontaxable nature of employer-provided benefits where employees are allowed to elect between taxable compensation and nontaxable benefits.
- Include new rules for determining if a cafeteria plan improperly discriminates in favor of highly compensated employees, including definitions of key terms. The new rules are generally consistent with the rules for qualified retirement plans. Also, the rules provide an objective test to determine if the actual election of benefits is discriminatory.
- Incorporate guidance previously issued relating to debit cards and grace periods for using health Flexible Spending Arrangements (health FSAs) money after the end of a plan year.
- Generally retain the rules in the prior regulations for health FSAs, including a 12-month plan year, requirements that the full reimbursement be available at anytime during the plan year, restrictions on changing elections in mid-plan year, and the requirement that unused amounts at plan year end are forfeited (the "use-or-lose" rule).

The IRS requests comments on the proposed regulations and will hold hearings on the proposed regulations on November 15, 2007. Taxpayers may rely on the proposed regulations for guidance pending the issuance of final regulations.

### [Proposed Regulations for Cafeteria Plans](#)