

Timing Rules – When must employee election forms be completed?

All eligible employees must make their election for the Plan prior to the effective date of the Plan. We must reject enrollment forms with signature dates after the effective date of the Plan. We contact the employer to advise them that according to IRS rules; the election must have been made prior to the effective date of the Plan, unless the employee was hired after the Plan Year started.

IRS regulations also do not allow the effective date of coverage to be retroactive to a date prior to the date the employee signed their election form. For this reason, we request that elections of employees who become eligible after the beginning any Plan Year to become effective the first day of the first pay period following the date the employer received the signed election form.

Eligibility/Participation Rules – Who does the IRS allow to participate?

The IRS has restrictions on who is eligible to participate in a section 125 Plan. The reason is, the person must meet the IRS definition of an employee. IRS rule's state that these types of companies may sponsor a section 125 Plan for their employees, but owners may not personally participate. Please see the participation rules below.

- Owners who own more than 2% in a subchapter S corporation are not allowed to participate. In addition, certain family members employed by the same company are not eligible to participate. The owner's following family members may not participate: parents, grandchildren, children or spouse.
- Generally partners in a partnership cannot participate.
- Owners/Partners in a Limited Liability Partnership (LLP), Limited Liability Company or Limited Liability Corporation (LLC) may not participate.

The owner of a sole proprietorship may not participate.

Discrimination Issues – What limitations are there for Highly Compensated or Key employees?

IRS rules do not allow Plans to discriminate in favor of highly compensated or key employees, with regard to eligibility or operation. We usually recommend employers use the same eligibility rules, waiting periods and level of benefits for all employees to help avoid the risk of their Plan being found to be discriminatory. There are tax penalties if a Plan is found to be discriminatory. Highly compensated or key employee's elections become taxable. Their election amounts must be lowered to an amount low enough to bring to the Plan into compliance. As a group, the highly compensated or key employees are only allowed to contribute a certain percentage of the benefits under the health care and dependent care FSA. The highly compensated or key employees may lose any dollars already contributed in excess of the new lower maximum election amount required to bring the Plan into compliance. This does not allow them to drop out of the Plan.

Eligible Benefits – What types of benefits are allowable under Section 125 Plans?

Section 125 Plans may include pre-tax premium for the following: accident or health coverage, short and long term disability*, accidental death and dismemberment coverage, and group term life insurance**. They may also include pre-tax contributions to flexible spending accounts for out of pocket health and dependent care expenses. Premium for Long Term Care is not allowed under Section 125 Plans or other benefits that defer compensation.

* Disability benefits paid to participants are generally taxable to the participant. This is true whether the employer pays all the premium, the employee pays all the premium on a pre-tax basis or the employer pays part of the premiums and the employee pays the rest on a pre-tax basis. The only time the disability payments would not be taxable, is if the employee paid the total cost on an after-tax basis. If the employer pays a portion and the employee pays the balance on an after-tax basis, then taxes are prorated according to what percentage was paid by the employer. That percentage would be applied to the actual benefit being paid. The percentage paid by the employer would be taxable income.

** Premium for the first \$50,000 life coverage may be deducted pre-tax. If the amount of term life coverage exceeds \$50,000 (the amount of premium required to purchase the coverage in excess \$50,000 must be reported as taxable income on the employee's W-2). If for example the employer provides all employees with \$25,000 in term life, but allows them to purchase up to (\$50,000) more as supplemental term life coverage, the employee could have premium to purchase an additional \$25,000 deducted from their pay on a pre-tax basis, the premium for the rest of the additional coverage would need to be deducted on an after-tax basis. Some employers find the bookkeeping to be cumbersome, so they do not include life insurance in their list of benefits that they will allow pre-tax premium for. In addition, you cannot deduct premiums on a pre-tax basis for dependent life or any type of life insurance that accumulates a cash value.