



Alerts

June 30th Plan Amendment Deadline for Cafeteria Plans Is Quickly Approaching

June 7, 2011

Insights for Employers

Among the changes made by last year's health care reform law is a limitation on the ability of participants in Health Flexible Spending Account plans (Health FSAs) and Health Reimbursement Accounts (HRAs) to receive reimbursements for certain expenses. As noted in the [April 26, 2010 issue of Hinshaw & Culbertson LLP's *Employment Practices Special Alert*](#), as of January 1, 2011, Health FSAs and HRAs may no longer reimburse participants for expenses related to nonprescription drugs, other than insulin. Thus, expenses incurred for medicines or drugs may be paid or reimbursed by Health FSAs or HRAs only if the medicine or drug: (1) requires a prescription, (2) is available without a prescription and the individual obtains a prescription, or (3) is insulin.

As this standard became effective January 1, 2011, cafeteria plans that offer Health FSAs are already required to be operated in compliance with the new reimbursement rules. Guidance issued last year, however, permits cafeteria plan sponsors to amend their plans retroactively to January 1, 2011, as long as such amendment is adopted no later than June 30, 2011 (regardless of the sponsor's plan year). Failure to meet this deadline could have significant adverse tax consequences for an employer's plan, including the possibility of all employee contributions to the plan being immediately taxable.

The new limitation on reimbursements also applies to Health Savings Accounts (HSAs) established for coverage under high-deductible health plans and to Archer Medical Savings Accounts (MSAs). If account holders of HSAs and MSAs receive a distribution for expenses for nonprescription drugs in violation of the new rules, such distributions will be subject to a 20 percent excise tax, in addition to being fully taxable to the account holder.

Another significant health care reform change impacting Health FSAs extends favorable federal tax treatment to medical expense reimbursements for an employee's children who have not attained age 27 as of the end of the employee's taxable year. Effective March 30, 2010, under a Health FSA, reimbursements for medical care are excluded from the employee's gross income where they are provided for an employee's adult child under the age of 27 as of the end of the employee's taxable year, regardless of that child's marital or dependent status.

This change complements the mandate under health care reform that generally

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required employers to offer health care coverage for adult children up to age 26. It allows the cost of coverage or eligible expenses incurred for the adult children to be funded or reimbursed through a Section 125 cafeteria plan with pretax dollars. The rule also extends favorable federal tax treatment to employer-provide health coverage for an employee's children who have not attained age 27. Any amendment to reflect this change will apply prospectively.

Employers should review their plan documents now to ensure compliance with these new requirements.

For further information, please contact [James D. Harbert](#), [Lisa M. Burman](#), [Anthony E. Antognoli](#) or your regular [Hinshaw attorney](#).

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