

## **Frequently Asked Questions Regarding POP Documents**

### **Question: What is a Premium Conversion Cafeteria Plan?**

#### **Answer:**

*Section 125 of the Internal Revenue Code permits employers to sponsor a plan that enables their employees to pay premiums for certain types of benefits on a pre-tax basis. Section 125 also permits employers to sponsor health and dependent care flexible spending account plans. These types of plans are referred to as "cafeteria plans." A plan that does not offer flexible spending accounts is often referred to as a "premium conversion," "premium only," or "POP" cafeteria plan.*

### **Question: Why does my client need a Premium Conversion Cafeteria Plan document?**

#### **Answer:**

*There are two really good reasons: First, providing a way for employees to pay for insurance benefits pre-tax will save you a lot of money in employment taxes. Second, the plan is probably an overlooked legal requirement. Many businesses deduct medical and other insurance premiums from payroll pay on a pre-tax basis, but they are not aware that they must adopt a written plan document under Section 125 of the Internal Revenue Code. The penalty for non-compliance may include payment of penalties and interest for delinquent taxes and disallowance of deductions.*

### **Question: When can my client adopt a Premium Conversion Cafeteria Plan?**

#### **Answer:**

*The Plan can be adopted at any time during the year. The Plan will operate on a 12-month "plan year" and employees will be permitted to change benefit enrollment elections before the beginning of each plan year. Most companies use a plan year that is either the calendar year or a 12 month cycle that corresponds to their health insurance contract renewal date. A plan can operate on a "short" plan year if you need or want to set it up so that it can begin reaping the tax benefits right away. For example, if the health insurance contract renews on April 1 and the Plan Year will be April 1 to March 31 of the following year, you can adopt the Plan on September 1 and have a short plan year for the period beginning September 1 and ending the following March 31. That way you can begin saving tax dollars right away.*

### **Question: What if my client already has a plan document?**

#### **Answer:**

*If the plan was adopted before 2002, it is out of date and needs to be restated. Significant changes to IRS regulations under Code Section 125 went into effect in 2002. In addition, the IRS published new proposed regulations in August 2007 that will go into effect in 2009, but plan sponsors can rely on these proposed regulations for administrative guidance in the interim period.*

**Question: How do I benefit from adopting a Premium Conversion Cafeteria Plan?**

**Answer:** *The biggest benefit is a reduction in Social Security and Medicare (FICA) taxes because annual payroll is reduced by the amount of premiums paid on a pre-tax basis. For example, assume you have 20 employees enrolled in health insurance and each employee pays \$1,200 a year in premiums, for an annual total of \$24,000 in payroll deductions for premiums. If employees pay premiums with after-tax dollars, your client must pay 7.65% of the \$24,000, or \$1,836, in FICA taxes. If employees pay on a pre-tax basis under the Premium Conversion Cafeteria Plan, your client saves \$1,836.*

**Question: How do my employees benefit from a Premium Conversion Cafeteria Plan?**

**Answer:** *An employee's take home pay will increase because the amount he or she pays for premiums is not subject to income taxes or FICA taxes.*

**Question: Who can participate in a Premium Conversion Cafeteria Plan?**

**Answer:** *Any employee who is eligible for the insurance benefits except:*

- *A Subchapter S corporation, a shareholder who owns more than 2% of the company*
- *If you are a limited liability company, members who are classified as self-employed for income tax purposes*
- *Partners in a partnership*
- *Self-employed individuals*

**Question: What types of insurance benefits can be paid on a pre-tax basis?**

**Answer:** *The Adoption Agreement for the plan has a checklist of all qualifying benefits. Premiums for medical, dental, and vision insurance are the most common benefits offered under a Premium Conversion Cafeteria Plan. If you offer a high deductible health insurance option with a Health Savings Account (HSA), an employee's HSA contributions may also be contributed pre-tax under the Premium Conversion Cafeteria Plan. Other available pre-tax benefits include life insurance and disability insurance, but there are additional tax considerations if these benefits are offered. Under current law, long-term care insurance premiums cannot be paid on a pre-tax basis.*

**Question: What do I need to administer a Premium Conversion Cafeteria Plan?**

**Answer:** *In addition to the plan documents you will provide, you will need to comply with two important legal requirements under Code Section 125:*

- *It will need to make employees aware that their enrollment elections are irrevocable for 12 months unless they experience certain qualifying life events, such as a change in marital status or change in number of dependents. All of these events are listed in both the plan document and the summary plan description; and*
- *Each year, you will need to perform a non-discrimination test to confirm that the plan does not favor "highly compensated individuals" or "key" employees. The instructions tell you how to administer this test. A plan that only offers health, dental, and vision insurance applies a "safe harbor" test that is easy to administer and pass.*

**Question:** Will I need to file any documents with the IRS or the Department of Labor?

**Answer:** *No – there are no filing requirements for Cafeteria Plans. A Form 5500 filing requirement was repealed for plan years beginning in 2002.*