



THE NEW USE IT OR LOSE IT RULE FOR CAFETERIA PLANS

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Use it or lose it," is the infamous principle of Section 125 flex/cafeteria plans. Positive account balances traditionally cause a December stampede to purchase eyeglasses and other medical what-nots. The expenses must be incurred by December 31 or the balance is forfeited to the employer.

For a country that wants to contain medical expenses, the rule that 125 savings must be spent or forfeited is a little silly. IRS has issued some welcome relief with new Notice 2005-42.

Starting with 2005, a cafeteria plan can now honor expenses incurred within two and one-half months following the end of the year. "Use it or lose it" remains the law, but a claims period of fourteen and one half months will provide a bit of relief.

Example: Jill has a \$100 positive account on December 31, 2005. It will not be forfeited on December 31 if the 125 plan is amended for this new rule. The \$100 can be used for expenses incurred through March 15, 2006. The \$100 will be spent before any expenditure of 2006 deferrals. If it is not spent, it will be forfeited on March 16, 2006.

Section 125 plans can still use a "run-out" period to pay claims. For example, a plan might allow participants until April 15, 2006 to submit claims for the period ended March 15, 2006.

Finally, the new rule continues to prohibit use of a 125 plan account surplus for a different purpose. For example, a healthcare account surplus cannot be used for dependent care.

Remember: You can only use this new rule for 2005 if your cafeteria plan is amended by December 31, 2005. You should leave enough time to communicate the new rule to participants.

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