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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 healthcare, 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 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.

## U.S. Obesity Epidemic Continues to Grow – What Can Employers Do?

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## Are You Losing More Than You Save?

The U.S. obesity rate continues to rise according to a recent study conducted by the Trust for America's Health (to see the full report and where your state ranks <http://healthyamericans.org/reports/obesity2007/>). According to the study obesity rates rose in 31 states last year and the rates of children at risk for being overweight or obese has tripled in 20 years. Eighty-five percent of Americans believe that obesity is an epidemic.

## Health Insurance Costs Expected to Grow Slightly in 2008

Obesity accounts for approximately \$117 billion in preventable healthcare spending. The National Business Group on Health reports that at least 8 percent of private employer medical claims are attributable to health claims caused by excess weight.

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Employers can take action to reduce obesity-related costs, including lost productivity and increased absence from disability. Such action includes:

- Share health information with employees and dependents to promote better awareness of health risks and encourage consumerism in healthcare decision making.
- Provide a range of incentives to encourage wellness and healthy life style behaviors.
- Improve the work environment to foster healthier habits.

National health leaders are sounding the alarm, calling obesity the most serious public health problem we face. Employers are demonstrating strong commitment to workplace programs, even as concern about the rising cost of employee benefits increases. The body of evidence-based information to support a return on investment is growing. Research published in *Preventive Medicine* showed that men over 50 years old who increase their physical activity levels had significant declines in their annual medical claims which resulted in a savings of approximately \$2000 per active person annually.

Additionally, research published in the *Journal of Occupational and Environmental Medicine* confirms the significant negative effect of obesity on productivity: high healthcare costs, lower health status, more absenteeism, and problem relationships at work. The same research showed that the quantity and quality of work improved with increasing levels of physical fitness.

Every step employers take to promote healthy weight and healthy lifestyle is a step in the right direction.

## Are You Losing More Than You Save?

To control the increasing cost of medical and drug expenditures, many employers have shifted costs - higher copays, tiered benefit plans and higher deductibles - to their workers. A study conducted by the nonprofit Integrated Benefits Institute (IBI) reveals that shifting costs to employees doesn't save employers money and discourages treatment essential to employees' health-related productivity and quality of life.

The three-year study focused on the medical histories of 5,483 workers with a diagnosis of rheumatoid arthritis (RA). The study found that employees appear to make medical decisions based on price and cost shifting, rather than evidence-based medicine. As copays go up, employees use their medications less. As a result, the study found, employers incurred \$17.2 million in costs from lost productivity, 26 percent more than the estimate of what they would have spent if the workers had taken their medications. Key findings of IBI's report include:

- Higher out-of-pocket expenses reduce medical adherence.
- Lower medication adherence is associated with higher short-term disability incidence and longer duration.
- Higher short-term disability incidence and longer duration results in greater costs and lower productivity.
- Data must be integrated across all health-related benefits programs to evaluate the true impact of management interventions.

## Health Insurance Costs Expected to Grow Slightly in 2008

According to PricewaterhouseCoopers' Health Research Institute medical cost trend is expected to be lower in 2008 compared with 2007. It is likely that premium increases will be lower in 2008 as well. Medical costs are expected to rise by 9.9% for PPOs, HMOs, and POSs, and 7.4% for consumer-directed health plans. Insurance companies use medical cost trends to estimate what a plan in 2007 would cost in 2008. While healthcare trends continue to outpace inflation, the trend is declining, reinforcing a longer trend pattern of deceleration according to PwC.

Mercer Health & Benefits predicts similar cost growth. According to their preliminary survey findings, health benefit cost growth will increase slightly in 2008. For the 1,557 employer health plan sponsors that have taken the survey so far, the total cost to renew their current health plans, with no changes, would grow by nearly 9 percent on average. However, the majority of respondents expect to achieve a lower increase by changing plans, by adding lower-cost options or by shifting costs to employees. In fact, 19 percent of employers with 500 or more employees, said they were "very likely" to implement a CDHP in 2008, up three percent from last year. Taking into account these changes, the actual increase expected for 2008 is just 6.7%. Last year, Mercer's annual survey found that average health benefit cost per employee rose 6.1% in 2006.

The Kaiser Family Foundation and the Health Research and Educational Trust reports that premium increases rose an average of 6.1% this year compared to 7.7% last year. The average annual premium for family coverage is \$12,106, and workers pay an average of \$3,281 to cover their share of the cost of a family policy. Cost-shifting is projected to continue. Twenty-one percent of employers are "very likely" to raise workers' premium contributions next year, while 13 percent are "very likely" to increase office visit co-payments. Another 12 percent are "very likely" to raise deductibles, while 11 percent are "very likely" to increase prescription drug co-payments.

**Please contact your HBEBG representative for more information.**