Board Agenda Item 48

DATE: November 7, 2023

TO: Board of Supervisors

SUBMITTED BY: Hollis Magill, Director of Human Resources

SUBJECT: Amend and Restate the Cafeteria Plan for the Employees of County of Fresno

RECOMMENDED ACTION(S):

Adopt a Resolution amending and restating the Cafeteria Plan for the Employees of County of Fresno.

There is no increase in Net County Cost associated with the recommended action. Your Board's adoption of the proposed resolution will amend the Cafeteria Plan for the Employees of County of Fresno (the "Cafeteria Plan") to 1) incorporate into the Cafeteria Plan, Board of Supervisors' Resolution Nos. 20-280 and 21-090; 2) add language to allow the County to offer a Health Savings Account (HSA) to its employees; and 3) update language related to forfeited Flexible Spending Account (FSA) contributions under the Cafeteria Plan.

Outside expert legal counsel has recommended that the County incorporate Board Resolution Nos. 20-280 and 21-090 into the Cafeteria Plan, in the event that the Cafeteria Plan is reviewed or audited by the IRS.

The proposed Cafeteria Plan language will allow the County to offer an HSA to its employees in compliance with applicable law and regulations, pursuant to guidance from outside expert legal counsel.

The proposed Cafeteria Plan language removes time constraints on the use of use forfeited FSA contributions (referred to as "forfeitures" in the Cafeteria Plan) to defray the cost of Cafeteria Plan expenses and further defines Reasonable Administrative Expenses related to the Cafeteria Plan.

This item is countywide.

ALTERNATIVE ACTION(S):

The alternative to the recommended action is to direct staff to revise the proposed resolution as it relates to forfeitures, by either removing or revising the proposed language. If the proposed language is removed, the County would have less flexibility to use forfeitures from prior years to defray the cost of Cafeteria Plan expenses. However, the County will not lose these forfeitures, and may use such forfeitures in the future to offset any losses experienced by the County, in the event that reimbursements are greater than contributions.

The language related to HSAs in the proposed Cafeteria Plan is required to effectuate your Board's approval of Agreement No. 22-568 with Navia Benefit Solutions, to administer the County's new HSA Program on December 13, 2022. Additionally, the language related to Board Resolution Nos. 20-280 and 21-090 in the proposed Cafeteria Plan is necessary to incorporate the Cafeteria Plan amendments pursuant to those Resolutions.

FISCAL IMPACT:

There are no costs associated with the recommended action.

DISCUSSION:

1. Section 125 Cafeteria Plans

A cafeteria plan is a written plan maintained by an employer for employees that meets the specific requirements of and regulations of section 125 of the Internal Revenue Code (the “Code”). The written plan must specifically describe all benefits and establish rules for eligibility and elections, and provides participants an opportunity to receive certain benefits on a pretax basis. Participants in a cafeteria plan must be permitted to choose among at least one taxable benefit (such as cash) and one qualified benefit.

A qualified benefit is a benefit that does not defer compensation and is excludable from an employee’s gross income under a specific provision of the Code, without being subject to the principles of constructive receipt.

A section 125 plan is the only means by which an employer can offer employees a choice between taxable and nontaxable benefits without the choice causing the benefits to become taxable. A plan offering only a choice between taxable benefits is not a section 125 plan.

Employer contributions to a cafeteria plan are made pursuant to a salary reduction agreement in which the employee agrees to contribute a portion of their salary on a pre-tax basis to pay for the qualified benefits. Since salary reduction contributions are not actually or constructively received by the participant, those contributions are not considered wages for federal income tax purposes. In addition, those sums are not subject to Social Security or Medicare taxes.

2. Cafeteria Plan for the Employees of County of Fresno (the “Cafeteria Plan”)

The Cafeteria Plan currently includes the following benefit options:

- **Premium Payment Plan (PPP),** which allows participants to make pre-tax salary reduction contributions to pay the employee’s share of the premium for the insurance plan(s), which include medical, prescription drug, dental, vision, accidental death & dismemberment, and group term life plans.
- **Health Flexible Spending Account (Health FSA)** to make pre-tax salary reduction contributions to an account for reimbursement of certain health care expenses, which are expenses incurred by a participant, or the participant’s spouse or dependent(s) for medical care.
- **Limited Scope Health Flexible Spending Account (Limited Scope Health FSA)** to make pre-tax Salary reduction contributions to an account for reimbursement of certain limited scope health care expenses, expenses incurred by a participant, or the participant’s spouse or dependent(s) for medical care, provided, however, that such expense is for vision, dental, or preventative care only.
- **Dependent Care Assistance Program (DCAP)** to make pre-tax Salary Reduction Contributions to an account for reimbursement of certain Dependent Care Expenses, which are expenses that are considered to be:
  - Employment-related expenses relating to expenses for the care of a qualifying individual necessary for gainful employment of the employee and spouse; and
  - Expenses for incidental household services, if incurred by the employee to obtain qualifying dependent care services, but only to the extent that the participant or other person incurring the expense is not reimbursed for the expense through any other plan.

  As it relates to the DCAP, a “qualifying individual” is the following:

- A tax dependent of the participant who is under the age of 13 and who is the participant's qualifying child;
- A tax dependent of the participant, who is physically or mentally incapable of self-care and who has the same principal place of abode as the participant for more than half of the year; or
- A participant's spouse who is physically or mentally incapable of self-care, and who has the same principal place of abode as the participant for more than half of the year.

The County has offered health and dependent care FSAs to participating employees since 1988. For Plan Year 2023, there are currently 1,539 employees enrolled in a health care FSA with approximately $2.3 million in annual elections; there are 82 employees enrolled in a dependent daycare FSA with approximately $277,000 in annual elections.

The Plan was most recently amended by the Board of Supervisors on April 13, 2021, to extend the deadline to incur eligible health care and dependent daycare expenses for benefit Plan Years 2020 and 2021, pursuant to the Consolidated Appropriations Act, 2021.

3. Health Savings Accounts (HSA)

An HSA is a personal savings account that allows participants to put money away and withdraw it tax free, as long as it is used for qualified medical expenses, such as deductibles, copayments, and coinsurance. To be eligible to contribute to an HSA, a participant must be covered by a high deductible health plan (HDHP). As it relates to an HSA -

- An HDHP is a health insurance plan that has a higher deductible than a traditional insurance plan (for calendar year 2023, the minimum deductibles to qualify as an HDHP are $1,500 for individuals and $3,000 for families).
- A deductible is the amount someone pays for covered health care services before their insurance plan starts to pay.

Unlike with an FSA, employees' contributions are not subject to a "use it or lose it" rule - unspent contributions roll over year-to-year and they do not expire. Employees who are 55 or older may contribute an additional amount to their HSA each year; the current "catch-up" amount is $1,000 for 2023.

As with the FSA benefit option, contributions to an HSA reduce the base upon which an employee's Social Security, Medicare, and Federal and State taxes are calculated, thereby reducing the amount of taxes paid by the employee and reducing Social Security and Medicare taxes paid by the County.

Withdrawals or reimbursements from an HSA for qualified medical expenses are tax free. However, if a withdrawal is taken before age 65 to pay for non-medical costs, or unqualified medical costs, such withdrawals are subject to income tax and a 20% tax penalty. Withdrawals from an HSA after age 65 for non-medical costs are not subject to the 20% tax penalty but are still subject to income taxes. It is the responsibility of participants to keep records of their medical costs and decisions, in the event they are audited by the IRS.

4. Cafeteria Plan Amendments Related to the COVID-19 Pandemic

In response to the COVID-19 pandemic, the Board of Supervisors adopted Resolution No. 20-280 on September 1, 2020, and Resolution No. 21-090 on April 13, 2021. In summary -

- The deadlines for HIPAA Special Enrollment rights, as referenced in Section 6.4 of the Cafeteria Plan, were extended for the duration of the Outbreak Period.
- The deadlines to incur expenses and to submit claims for reimbursement were extended for Plan Years 2019, 2020 and 2021.

- The appeal deadlines, as referenced in Section 7 of the Cafeteria Plan, were extended for the duration of the Outbreak Period.
- The deadlines for employees to elect COBRA continuation coverage and to timely pay the applicable COBRA premiums, as referenced in Schedules A, B, and C of the Cafeteria Plan, were extended for the duration of the Outbreak Period.

The Outbreak Period, as it relates to the COVID-19 pandemic, refers to the period of time from March 1, 2020, until 60 days after the announced end of the COVID-19 National Emergency or such other date announced by the Employee Benefits Security Administration and the Internal Revenue Service in future guidance. The Outbreak Period ended on July 10, 2023, as President Biden officially ended the COVID-19 Public Health Emergency on May 11, 2023.

Resolution Nos. 20-280 and 21-090 serve as amendments to the Cafeteria Plan through express language stating the Cafeteria Plan is amended to effectuate the actions summarized above and because the resolutions were approved by the Board of Supervisors. According to the Cafeteria Plan, the County can amend the plan by having the Chair of the Board of Supervisors sign an amendment and having the Clerk of the Board provide an attestation.

5. <u>Forfeitures</u>

The Cafeteria Plan defines forfeitures in Schedules B, C, and D as the remaining balance in a participant's FSA, after all reimbursements have been made for the Plan Year, except for expenses incurred during an applicable Grace Period.

The Cafeteria Plan currently provides the following direction regarding the use of forfeitures and expenses related to administering the Cafeteria Plan:

- Schedules B, C, and D of the Cafeteria Plan allow forfeitures to be used as follows:
    - First, to offset any losses experienced by the County during the Plan Year as a result of making reimbursements with respect to any participant in excess of the contributions paid by such participant through salary reductions; and
    - Second, to reduce the cost of administering the FSA during the Plan Year or the subsequent Plan Year (all such administrative costs shall be documented by the plan administrator).
- Section 8.4 of the Cafeteria Plan currently states: The Plan Administrator may employ such counsel, accountants, claims administrators, consultants, actuaries and other person or persons as the Plan Administrator shall deem advisable. The Plan shall pay the compensation of such counsel, accountants, and other person or persons and any other reasonable expenses incurred by the Plan Administrator in the administration of the Plan. Unless otherwise provided in the service agreement, obligations under this Plan shall remain the obligations of the Employer and the Plan Administrator.
- Section 10.1 of the Cafeteria Plan currently states: All reasonable expenses incurred in administering the Plan are currently paid by forfeitures to the extent provided in Schedules B, C, and D and then by the Employer.

6. <u>Engagement of Liebert Cassidy Whitmore</u>

The County has an existing legal services agreement (Agreement No. 20-057) with Liebert Cassidy Whitmore ("LCW"), a law firm specializing in legal issues relating to section 125 cafeteria plans. Staff engaged LCW, through its San Diego office, to advise and assist with the legal review of the Cafeteria Plan, as described below.

<u>HSA Guidance</u>

On December 13, 2022, the Board of Supervisors approved Agreement No. 22-568 with Navia Benefit Solutions to administer the County's FSA and HSA Programs. As the HSA Program will be a new benefit offered to employees, upon the Board of Supervisors' approval of Agreement No. 22-568, staff sought to ensure that the Cafeteria Plan followed all applicable HSA laws and regulations.

In a May 5, 2023 opinion letter, LCW advised the County that, while Agreement No. 22-568 enables the County to offer the HSA to eligible County employees, the Cafeteria Plan needed to be amended to add a written description of the HSA benefit that follows the relevant federal tax laws and regulations. LCW provided recommended language to bring the Cafeteria Plan into compliance with the relevant tax laws and regulations; pursuant to this guidance, the following updates were made to the Cafeteria Plan:

- Language was added to Section 1 to add HSAs as a benefit option.
- Language was added to Section 6 to state that irrevocability rules under the Cafeteria Plan do not apply to HSAs.
- Language was added to the Glossary to define an HSA-Eligible Individual.
- A new Schedule E was added, which details the terms and conditions of the new HSA benefit option.

<u>Resolution Nos. 20-280 and 21-090 Guidance</u>

As stated above, the Board of Supervisors adopted Resolution Nos. 20-280 and 21-090 in response to the COVID-19 pandemic. In the aforementioned May 5, 2023 opinion letter, LCW recommended that, in order to maintain a complete record and for purposes of clarity, the County attach and incorporate Resolution Nos. 20-280 and 21-090 to the Cafeteria Plan document. In the event that the IRS were to audit or review the County's Cafeteria Plan document, Resolution Nos. 20-280 and 21-090 would be incorporated as amendments authorizing the extended grace periods for Plan Years 2019, 2020, and 2021.

The proposed Cafeteria Plan includes an Appendix C which attaches and incorporates the changes made to the Cafeteria Plan pursuant to Resolution Nos. 20-280 and 21-090.

<u>Forfeiture Guidance</u>

As part of the amendment and restatement process, staff sought guidance related to the County's unused forfeitures, as related to the FSA benefit option. Specifically, staff sought to-

- Clarify what expenses may be defrayed using forfeitures and determine whether applicable law would allow the County to use forfeitures to cover the wages of the employees who work on the Cafeteria Plan benefits.
- Identify the legal standards in documenting reasonable expenses incurred in administering the Cafeteria Plan, and if the Cafeteria Plan should detail a process for the documentation.
- Determine whether there is a maximum amount of forfeitures that an employer may have on hand and whether there is a required period of time in which to use forfeitures to defray reasonable expenses.

In an August 25, 2023 opinion letter, LCW advised the following:

- Current County staff costs may not be defrayed by forfeitures. Under the Department of Labor (the "DOL") requirements, an expense is not directly related to FSA administration "to the extent it would have been sustained had the service not been provided." However, the cost of outside legal counsel and other similar expenses are allowable, as long as those expenses are related to the Cafeteria Plan. This is because, unlike the cost of current County staff, such outside expenses would not be incurred if the County did not offer the services provided under Cafeteria Plan.

Pursuant to this guidance, Section 8.4 of the Cafeteria Plan was updated to clarify that expenses related to the County's employment of counsel, accountants, claims administrators, consultants, actuaries and other person or persons in the administration of the Cafeteria Plan shall be defrayed by forfeitures. Section 10.1 was updated to clarify that reasonable administrative expenses shall be defrayed by forfeitures.

- Regarding the use of forfeitures other than to offset any losses experienced by the County as a result of paying claims, based on the Regulations and DOL guidance, the County needs to maintain detailed records demonstrating: 1) the individual or entity to whom the expense was paid; 2) the nature of the expenses, clearly demonstrating that they relate directly to the administration of the Health FSA, Limited Scope Health FSA, or the DCAP; 3) the amount of the expenses; and 4) the dates on which they were incurred.

  LCW did not advise the County to include the documentation process in the Cafeteria Plan; therefore, no additional language was added.

- Schedules B, C, and D of the Cafeteria Plan state that forfeitures used to defray the cost of reasonable administrative expenses must be used during the Plan Year or the subsequent Plan Year. However, the Regulations do not require that forfeitures used to defray reasonable administrative expenses be used within a specified time frame. The Regulations do not specify any consequences for using unused forfeitures outside of the time limits specified. In addition, there do not appear to be any regulations or guidance that specifies a maximum amount of forfeitures that an employer may have on hand at any one point in time

  Pursuant to this guidance, Sections related to the use of forfeitures in Schedules B, C, and D were updated to remove the time limit in which the County may use such forfeitures to defray the cost of reasonable administrative expenses. In addition, Language was added to define an HSA-Eligible Individual and to define a Reasonable Administrative Expense.

7. <u>Summary of Substantive Proposed Changes to the Cafeteria Plan</u>

Exhibit A includes a "redline" version of the current Cafeteria Plan with the proposed changes added, for your Board's reference. The final version of the Cafeteria Plan is attached to the Resolution. The substantive changes from the current Cafeteria Plan are summarized below.

- Section 1: Language was added to add HSAs as a benefit option.
- Section 6: Language was added to state that irrevocability rules under the Cafeteria Plan do not apply to HSAs.
- Section 8.4: The language was changed to clarify that expenses related to the County's employment of counsel, accountants, claims administrators, consultants, actuaries and other person or persons in the administration of the Cafeteria Plan shall be defrayed by forfeitures.
- Section 10.1: The language was changed to clarify that Reasonable Administrative Expenses shall be defrayed by forfeitures.
- Glossary: Language was added to define an HSA-Eligible Individual and to define a Reasonable Administrative Expense.
- Appendix C: The is a new Appendix, which incorporates Board Resolution Nos. 20-280 and 21-090 into the Cafeteria Plan.
- Schedules B, C, and D: Sections related to the use of forfeitures were updated to remove the time limit in which the County may use such forfeitures to defray the cost of Reasonable Administrative Expenses.
- Schedule E: This is a new Schedule, which details the terms and conditions of the new HSA benefit option. Of note:

    - To be eligible to participate in the HSA benefit, an employee must receive coverage under an HDHP that is sponsored by the County or by a certified employee organization.
    - The County may, but is not required to, make contributions to employees' HSA accounts.
    - Employees may increase, decrease, or revoke their elections prospectively, on a monthly basis, at any time during the Plan Year.

- Miscellaneous: The signature block at the end of the Cafeteria Plan was deleted. Staff determined that the extra signature block would be redundant with your Board's approval of a resolution adopting the proposed Cafeteria Plan.

8. Staff Next Steps

Staff has incorporated the new HSA benefit into the County's open enrollment process for employee benefits. Employees who are covered by a County-offered HDHP will be allowed to participate in the HSA benefit, with deductions beginning on the January 5, 2024 paycheck.

OTHER REVIEWING AGENCIES:

LCW, a law firm specializing in legal issues relating to section 125 cafeteria plans, has advised and assisted the County on the matters discussed above.

REFERENCE MATERIAL:

BAI #41, December 13, 2022
BAI #38, April 13, 2021
BAI #28, September 1, 2020
BAI #30, February 4, 2020

ATTACHMENTS INCLUDED AND/OR ON FILE:

On file with Clerk - Exhibit A
On file with Clerk - Resolution

CAO ANALYST:

Paige Benavides