Legacy M&A Advisors LLC

# M & A UPDATE®

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## Cafeteria Plans and the New Healthcare Law

***Bart A. Basi, CPA/Attorney at Law***
***The Center for Financial, Legal & Tax Planning, Inc.***

### Introduction

Is there anything good on the menu today for cafeteria plans? Yes, actually there is something new on the menu and everyone is going to enjoy it. A little known provision in the Patient Protection and Affordable Care Act of 2010 contains a section making cafeteria plans better than what they used to be for all firms with less than 100 employees.

### Basics Behind the Cafeteria Plans

The "cafeteria plan" (otherwise known as the "flexible benefit plan" or "125 plan") is simply an employee benefit plan that conforms to Section 125 of the Internal Revenue Code. Benefits can include health and accident insurance, adoption assistance, dependent care assistance, group term life insurance, and health savings accounts. The mechanics of the cafeteria plan works much like a cafeteria that serves food. An employee is issued a certain amount of money that can be used to purchase company offered benefits. The company then offers the employee a choice of benefits that the employee can spend the allocated amount of money on. Because employees' needs vary by age, family status and situation, the employee chooses the benefits that further their individual goals the most. Either the employee can spend all of the allotted funds on various benefits, on some benefits, or even no benefits. Whatever benefits are not utilized may be lost. Any amounts above and beyond the benefits purchased by the employee must be paid directly by the employer in the form of a payroll deduction. In other cafeteria plans, the employees are not necessarily given an allowance, but are offered a direct payroll deduction.

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## A CASE STUDY

In a Revenue Ruling, the IRS has found that an S Corporation's accumulated adjustments account (AAA) is not increased by insurance proceeds received by the corporation for the death of an employee if such proceeds are not taxable. Conversely, the administrative court also ruled that such accounts are not reduced by premiums paid on a life insurance policy by the company.

In the set of facts considered by the IRS, an S Corp bought life insurance on one of its highly paid executives. The company is the beneficiary and pays the premiums. In this situation, the IRS has ruled that the payment of the premiums does not reduce the company's AAA and that any of the proceeds received by the company will be excludable from income and, thus, not increase the AAA.

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Cover Story

The employee may then choose to spend their pre-tax money on benefits or take it as compensation. The money, in either type of an arrangement, is deducted from the employee's pre-tax compensation, making the plans tax beneficial as well.

Due to the cost of healthcare and other benefits available under the cafeteria plan, cafeteria plans are widely used and employees enjoy the benefits. The Internal Revenue Code dictates the mandates of cafeteria plans. Among the mandate under Section 125, the plans cannot be top heavy benefitting only highly paid employees. Another significant limitation in the regular 125 Plan is that of the 2% owner. Generally the business owner cannot participate in the cafeteria plan.

### Section 9022 of the New Healthcare Law (New Simple Cafeteria Plan)

To view the full text of Section 9022, please visit our website at [www.taxplanning.com](www.taxplanning.com).

For tax years starting after December 31, 2010, Section 9022 of the PPACA applies giving rise to the Simple Cafeteria Plan. The most notable feature of the Simple Cafeteria Plan is a basic elimination of the top heavy rules for employees. To be an eligible employer, the employer must have had an average of less than 100 employees figured per day for the past two years. Employees must have worked at least 1000 hours for the past plan year. If the employee is under 21, or has worked less than one year, or has a collective bargaining agreement, or is not a citizen of the United States, such employees may be excluded form the plan. There are two contribution limits a plan must conform to. One is a uniform percentage of two percent of the employee's income, or an amount which is not less than the lesser of six percent of the employee's compensation for the plan year, or twice the amount of the salary reduction contributions of each qualified employee.

The benefit of this plan is that employers can open simple plans to their employees and also participate in the new plans without having the constant threat of their deduction being held in jeopardy by violating numerous rules including the top heavy rules.

### Conclusion

Here, at The Center for Financial, Legal, and Tax Planning, we do not favor one piece of legislation over another, nor do we endorse any special treatment for those who enacted any and all legislation. Our task is to keep the public informed of what is available for use and what can benefit them the most in any given tax law, finance situation, or any law generally. Section 9022 is a hidden gem for any closely-held business owner and their employees.

***Dr. Bart A. Basi is an attorney, CPA, and the Senior Advisor of The Center for Financial, Legal & Tax Planning, Inc, a full service company specializing in financial, legal & tax matters. Basi is a nationally recognized author, lecturer, and advisor on how to structure deals to minimize taxes. Tax structure makes the difference between getting the deal done and watching the deal fall apart. Many of you may be familiar with Basi and the topics he covers in the Financial, Legal & Tax Advisory which may be read in various industry-specific trade publications.***

## Points of Interest

- **A little known provision in the Patient Protection and Affordable Care Act of 2010 contains a section making cafeteria plans better.**
- **For tax years starting after December 31, 2010, Section 9022 of the PPACA applies giving rise to the Simple Cafeteria Plan.**
- **The benefit of this plan is that employers can open simple plans to their employees and also participate in the new plans without having the constant threat of their deduction being held in jeopardy by violating numerous rules including the top heavy rules.**

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## A CASE STUDY CONTINUED:

**Editor's Comment: This ruling is helpful in that it provides companies with some guidance regarding their accumulated adjustments accounts. Such life insurance polices purchased by a company on one of its integral employees is not uncommon and commonly referred to as a "key-man policy." This Revenue Ruling may help some executives determine whether such a policy is appropriate for their company.**


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## *Avoid the Major Pitfalls in Selling A Business No. 3 – Allowing Emotion to Overrule Reason*

Selling a business is something that most business owners will only attempt once in their career. With an estimated 70% - 90% of their total net worth tied up in their business, they can't afford to make a costly mistake, but their success in running their own business generally doesn't prepare them to handle one of the largest and most crucial financial transaction in their life.

This is the third in a series of articles exploring some of the common pitfalls in selling a business: Major Pitfall No. 3 -- Allowing Emotion to Overrule Reason.

By the time most owners come to sell, they've invested most of their working life in building the business to its present size and profitability. In addition to their considerable investment of time and money, they understandably have a tremendous psychic and emotion investment as well. Many owners, and especially founding owners, tend not to respond well to questions about why things are done a certain way, or suggestions on ways the business might be further improved, or observations that the business may have certain systemic weaknesses even while acknowledging that it has many strengths.

It is for similar reasons, I suppose, that residential real estate agents prefer/insist on showing a home to a prospective buyer WITHOUT the owner present. This is obviously not feasible – or even desirable, in most cases -- when showing a business.

Because selling a business can be emotionally gut-wrenching and that emotion can spill over into irrational reactions to prospective buyers in the sales process and potentially damage or even derail an otherwise successful sale, a principal role of the M&A intermediary, is to keep the process and the discussion as objective and rational as possible.

Determining the fair market value is one issue sellers commonly have difficulty with. They are inclined to associate value with the years they put into the business, the investment they made in plant and equipment, and how much it would cost to replace it all, rather than from the perspective of what level of investment/acquisition price will the business support today with its current and projected profit and cash flow and still give the investor/buyer a fair return on his investment.

The successful sale of a business requires a carefully planned approach in which each step is done right. While owners are experts at successfully running their own organization, few are equipped to navigate this complex process and, therefore, they are at a distinct disadvantage. The use of professional advisors who can provide the expertise, support and representation required to sell a business for the best price and terms will typically more than pay for itself.

*If you know of a business owner who's thinking of selling or buying a business and who might benefit from a free, confidential, consultation with us, have them contact me directly, and in strictest confidence, at 813.299.7862, or via e-mail at mertel@legacymandaadvisorsgroup.com*


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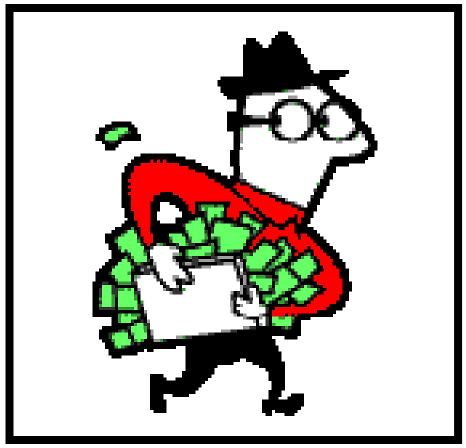

We're on the Web!

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# Frequently Asked Questions…

**Q: What is a Series Limited Liability Company (Series LLC)?**

**A: A Series LLC is a company created and formed under state statute that is similar to a regular LLC. The difference is that assets are placed into series for the purpose of gaining additional liability protection. They are only available in a limited number of states, but are gaining momentum in their popularity.**

**Q: Can I convert my regular LLC into a Series LLC?**

**A: Yes and no. From a legal standpoint, you cannot change the form of your company from an LLC to a Series LLC directly. If you want to make such a transformation, a Series LLC must be formed separately and independently. From that point, the assets can be transferred from the old LLC to the new Series LLC.**

**Q: What is the IRS's position on the Series LLC?**

**A: Generally, the Series LLC is recognized by the IRS as a legitimate entity. Tax returns will be filed according to the appropriate elections made by management and their counsel.**