This presentation is directed towards governmental school districts and does not contain information that might apply to other types of employers.

Cafeteria Plans

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What Is a Cafeteria Plan?

- Arrangement authorized by IRC §125. Also known as a "flexible benefits" program
- Created by Employer
- Employees choose from a compensation menu including taxable and certain nontaxable benefits (Qualified Benefits)

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Qualified Benefits Permitted Under a Cafeteria Plan

- Premium conversion (POP)
- Employer-provided health coverage (Code §105 or 106)
- Flexible spending accounts (FSA)
- Dependent care (Code §129)
- Group-term life insurance (However, in excess of $50,000 can result in gross income to insured employee.)
- AD & D insurance (Code §106)
- STD and LTD insurance (Code §106)
- Adoption assistance (Code §137)
- Health Savings Account (HSA) contributions (Code §233)
- School Systems only can provide fully prepaid post-retirement term life insurance.

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Taxable Benefits

- Cash
- Taxable benefits

  Example: PTO e.g. vacation, sick and personal days) . But , Plan must require that employee receive cash for, use or forfeit PTO before the last day of the Plan Year to which the elective contributions relate.

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Eligibility

Cafeteria Plans may provide benefits to:

- Employees
- Former employees such as retirees. But not primary purpose.

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Value to Employees

- Advantages:
  - No federal income tax or FICA or Medicare tax
  - Generally, no state or city tax
  - Flexible choices among benefits (or cash)
  - Increased take-home pay (vs. after-tax payment)
- Disadvantages
  - Irrevocable elections
  - Use-it-or-lose-it rules
  - Possibly lower Social Security benefits

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Value to Employers

- Advantages:
  - No Employer share of FICA or Medicare tax
  - Shift coverage costs to employees who pay through salary reductions
  - HSA contributions not subject to HSA comparability (nondiscrimination rules)
- Disadvantages for employers:
  - Set-up and administrative costs
  - Health FSAs subject to Uniform Coverage Rules

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Plan Contributions

- Salary reduction agreements.

  Employee accepts reduced salary with the difference (which is pre-tax) used to purchase benefits.

- Employer contributions.

- Some Plans allow employee after-tax contributions (rarely).

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Deferred Compensation Prohibition

- Benefit options cannot result in deferral of compensation.
- One year's plan contributions cannot be used to purchase benefits in another year.
- Exceptions:
  - HSA contributions
  - Certain Grace periods (up to 2 ½-mos. after end of plan yr.)
  - LTD policy
  - Advance payments for orthodontia
  - Year end salary reduction may pay premiums at beginning of next year

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Cafeteria Plan Document Requirements

- Required written plan document describing:
  - Eligibility for Participation Rules
  - Available Benefits; Period of Coverage
  - Benefit Election Procedures
  - How Contributions are Made
  - Maximum Employer contribution per participant (if any),
  - Maximum Employee elective contribution (salary reduction)
  - The Plan Year
- The Plan must be:
  - Operated in accordance with terms in the document
  - Adopted and effective on or before first day of plan year

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Enrollment and Election Rules

- Generally, elections must be made before beginning of coverage period (generally 12 mos.)
- New hires may be allowed to make initial elections within 30 days, retroactive to date of hire. However, all pre-tax amounts must be taken from future pay
- Electronic elections are permissible

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"Negative" elections are permitted

- May be "automatic" – if enrolled in health plan, premiums must be pre-tax
- May be "default" – if enrolled in health plan, premiums will be pre-tax, unless employee elects after-tax
- May be "evergreen" – renewed from year to year unless changed (less common with FSAs)

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Enrollment and Election Rules

- Generally, elections are irrevocable for the Plan Year
- Exceptions to irrevocability are specified in IRS regulations; exceptions must be described in the Plan document

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Exceptions to Irrevocability of Elections

- Change in status events
  - Birth, adoption, marriage, divorce, leave of absence, strike, lockout, change of worksite
  - Election change must be "consistent with" change in status
    - ✓Limits who may add or drop coverage
    - ✓Timely request to change required (though no specific deadline)

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Exceptions to Irrevocability of Elections

- HIPAA special enrollment events
  - Substantial overlap with status changes
  - Two new events under "CHIPRA";
    - ✓Loss of eligibility for CHIP or Medicaid
    - ✓Entitlement to premium subsidy under either program
  - May allow even unaffected dependents to be enrolled at same time (i.e., no "consistency" requirement)
  - Specific timeframes for enrollment
    - ✓ Generally must request change within 30 days
    - ✓ 60 days for CHIPRA events

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Exceptions to Irrevocability of Elections

- Cost changes
  - If "insignificant" may automatically adjust pre-tax premiums
  - If "significant" may allow election change
  - Not applicable to FSAs
- Coverage changes
  - If "significant" may allow move to other option
  - If change amounts to "loss of coverage" may allow revocation of election
  - Not applicable to FSAs

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Exceptions to Irrevocability of Elections

Court Orders:

- May allow employee to add dependent child or foster child if employee is ordered to cover child
- May allow employee to drop child from coverage if other parent is ordered to cover child and in fact does so

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Exceptions to Irrevocability of Elections

Medicare or Medicaid

- Employee may be allowed to drop coverage for self or dependent upon becoming entitled to Medicare or Medicaid

- Similarly, employee or dependent who loses Medicare or Medicaid coverage may be allowed to enroll

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Employees on FMLA Leave

- Employee:
  - Must be allowed to continue health coverage at active-employee premium
  - Must be allowed to revoke coverage
- Employer:
  - May waive employee premium payments while on unpaid leave (on a nondiscriminatory basis)
  - May offer employee premium payments under 3 options:
    - ✓ Prepay
    - ✓ Pay-as-you-go
    - ✓ Catch-up

    Must be consistent with offering to employees on non-FMLA leave

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Nondiscrimination Tests

"Highly Compensated Individuals" and/or Key Employees (as applicable) are taxed on the maximum taxable benefit they could have elected to receive if the Plan discriminates.

First Test: Cafeteria plans may not discriminate in favor of "highly compensated individuals" as to eligibility, contributions, or benefits.

"Highly compensated individuals" include: officers, employees who are highly compensated based on facts and circumstances (e.g. earning at least $110,000 in 2011) and Spouses of the foregoing

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Nondiscrimination Tests

Second Test: Key Employee Concentration Test: "Key Employees" may not receive more than 25% of the Plan's total non-taxable benefits.

"Key Employees" include officers earning more than $160,000, subject to a limit on number of officers.

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Nondiscrimination Rules

- “Safe harbor” rule for premium-only plans

  All employees can participate and can elect the same salary reductions for the same benefits.

- Underlying Benefits May Be Subject To Other Nondiscrimination Tests

  Dependent care – §129;

  Medical Reimbursement §105;

  Group Term Life §79

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Flexible Spending Accounts

- Health FSAs may reimburse medical expenses. But not premiums.
- Dependent Care Assistance FSAs – may reimburse dependent care expenses if no tax credit is claimed
- Adoption Assistance FSAs – may reimburse adoption expenses if no tax credit is claimed

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Special FSA Rules

➢ All FSAs subject to
- Substantiation requirements
- Use-It-or-Lose-It" rule, although
  - DFSAs and adoption assistance FSAs may allow for "spend-down"
  - Any FSA may allow for 2 ½ mos. grace period

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Special Health FSA Rules

➢ Uniform Coverage Rule -
Maximum reimbursement must be available, reduced by use

➢ May allow qualified reservist distributions

➢ Existence may negate ability to maintain HSA - Coordination is necessary

➢ Limited COBRA may apply

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Health Care Reform: Health FSAs (and HSAs)

- 2011 –HFSAs and HSAs
  - No reimbursements for OTC drugs (other than insulin) unless prescribed
- 2013 -Health FSAs contribution
  - Annual salary-deferral limit of $2,500 (indexed for inflation)
- 2010 -Cover Children – up to age 27

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Health Care Reform
Safe Harbor "Simple" Cafeteria Plans

- Deemed to satisfy Cafeteria Plan and certain component benefit nondiscrimination rules, such as
  - ✓ Group-term life insurance
  - ✓ Self-insured medical coverage
  - ✓ Dependent care assistance
- To be eligible, employer must:
  - Average 100 or fewer employees during past 2 years
  - Make minimum non-elective contribution for each eligible employee

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Simple Plan Employer Contribution Requirements for Each Qualified Employee

- Uniform percentage (not less than 2%) of comp.

<u>Or</u>

- At least 6% of comp. or twice the salary reduction contributions of each employee, whichever is less. And, the rate of contribution to any salary reduction contribution of a HCE or Key Employee can not be greater than the rate to any other employee.

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Thank You

Questions

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