

# Plan Document

---

## **Every cafeteria plan must have a written plan document**

- Must be formally adopted by employer prior to first day of plan year
- No cafeteria plan document = adverse tax consequences
- Must be consistent with plan administration
- Benefits that are funded under cafeteria plan may also need plan document (separate documents or sometimes combined)



# Plan Document

---

## **Cafeteria plan document should address:**

- Participation rules
- Description of available benefits
- Election procedures
- Types of contributions
- Maximum contribution amount for each benefit
- Plan year
- Specific provisions for available benefits
  - For example, grace period rules for health or dependent care FSAs



# Nondiscrimination Rules

---

Cafeteria plans must pass three nondiscrimination tests:

- Eligibility to participate
- Benefits and contributions
- Key employee concentration

Tests are designed to ensure plan does not discriminate in favor of highly compensated employees



# Three Main Tests

---

## Eligibility Test

- Sufficient number of non-highly compensated individuals must be eligible to participate in the plan

## Benefits and Contributions Test

- Contributions and benefits must be available on nondiscriminatory basis
- Test looks at availability and utilization
- Plan must also be nondiscriminatory in operation

## Key Employee Concentration

- Key employee contributions cannot exceed **25 percent** of the total contributions into the plan



# Reporting and Disclosure

---

## Form 5500

- Not required for cafeteria plans
- ERISA benefits offered under cafeteria plan are subject to reporting (unless an exception applies)

## Disclosure

- No participant disclosure requirements for cafeteria plans
- Disclosure requirements may apply to cafeteria plan's benefit components



# Who Can Sponsor?

---

Any employer with employees subject to U.S. income taxes, no matter what its size, can sponsor a cafeteria plan.

- Private sector employers
- Nonprofit organizations
- Government entities
- Sole proprietorships



# Who Can Participate?

---

**Only current and former employees can participate in a cafeteria plan**

## **Common law employees**

- Includes current and former common law employees (for example, COBRA beneficiaries)
- Subject to nondiscrimination rules, employers can have different eligibility rules for different classes of employees and qualified benefits

## **Other eligible employees**

- Leased employees
- Full-time life insurance salespersons who are statutory employees for FICA purposes



# Who Cannot Participate?

---

## Spouses and Dependents

- Spouses and dependents cannot make their own cafeteria plan elections (although employee may elect coverage for them)

## Self- employed individuals

- Although self-employed individuals can sponsor a cafeteria plan for their employees, they cannot participate. Self-employed individuals include:
  - Partners in a partnership
  - Sole proprietors
  - Non-employee directors serving on corporation's board of directors
  - More-than-2% shareholders in Subchapter S corporation



# Coverage for Spouses and Dependents

**Can only offer qualified benefits to employees, spouses, dependent children and tax dependents**

## Who Is a Spouse?

- All legally married same-sex or opposite-sex spouses, regardless of where they live

## Who Is a Dependent Child?

- An employee's child who is under age 27 at the end of taxable year

## Who Is a Tax Dependent?

- "Qualifying child" or "qualifying relative" under Code §105(b)

# Coverage for Domestic Partners

---

**Cannot pay for domestic partner's health coverage on pre-tax basis, unless domestic partner is a tax dependent**

## **Tax rules for domestic partners**

- Have the same address as employee;
- Be a member of employee's household;
- Receive more than half of support from employee;
- Not be anyone's "qualifying child" for tax purposes; and
- Be a citizen or national of the U.S., or a resident of the U.S. or a country contiguous to the U.S.



# Qualified Benefits

---

## Benefits that may be offered under a cafeteria plan

- Accident or health plan coverage (HMO, PPO, etc.)
- Accidental death and dismemberment (AD&D) coverage
- Adoption assistance benefits
- COBRA coverage (if participant has compensation that can be used to pay for COBRA pre-tax)
- Dependent care assistance benefits
- Dental benefits
- Disability benefits (short-term or long-term coverage)
- Health FSA contributions
- Health savings account (HSA ) contributions
- Life insurance (on employee's life)
- Vision benefits
- 401(k) contributions



# Non-qualified Benefits

---

## Benefits that cannot be offered under a cafeteria plan

- Archer medical savings accounts (Archer MSAs)
- Educational assistance plans
- Employer-provided meals and lodging
- Fringe benefits
  - Transportation fringe benefits
  - Moving expense reimbursements
  - Retirement planning services
- Health reimbursement arrangements (HRAs)
- Individual insurance policies (major medical coverage) – Exchange or non-Exchange plans
- Life insurance on spouse's or dependent's life
- Long-term care insurance or services
- Scholarships
- 403(b) contributions



# Cafeteria Plan Contributions

---

**Cafeteria plan benefits can be funded in a variety of ways**

## Employee contributions

- Employees reduce salary on a pre-tax basis to pay for benefits
- Not subject to federal income or employment taxes

## Employer contributions

- Employer may contribute toward cost of benefits
  - Fixed amount for specific benefits
  - Matching contributions
  - Contingent contributions
  - Discretionary flex credits



## Amount of Employer Contributions

---

### **May vary from benefit to benefit**

- Plan design preferences
- Legal restrictions for certain benefits (for example, health FSAs)

### **May vary for different groups of employees**

- Concern is nondiscrimination rules



# General Rules

---

## Timing

- Elections must be made **in advance** on a prospective (not retroactive) basis
  - Annual open enrollment period
  - Mid-year enrollment window for new hires or mid-year election changes
  - Narrow exception for certain HIPAA special enrollment events

## Voluntary

- Elections must be **voluntary**
  - Must be a choice between taxable benefit and qualified benefits
  - Some employers offer choice between pre-tax and after-tax benefits
  - Permissible to require pre-tax funding of health insurance

# Mid-Year Election Change Events

---

Change in status

- Major life events (marriage, birth, adoption, employment changes)

Cost or coverage changes

- Changes to qualified benefits under cafeteria plan

Other laws or court orders

- Coordinate cafeteria plan rules with other laws (for example, HIPAA, COBRA and ACA)

IRS recognizes three broad categories of mid-year election change events





## General Rules

---

- For an employee to be eligible to change his or her election during a plan year—
  - Employee must experience a mid-year election change event recognized by IRS
  - Cafeteria plan must permit mid-year election changes for that event
  - Requested election change must be consistent with the event



# Change in Status Events

---

- Change in employee's **legal marital status**
- Change in the **number of dependents**
- Change in **employment status**
- Change in **residence** of employee, spouse or dependent
- Commencement or termination of **adoption proceedings**
- A dependent satisfies (or ceases to satisfy) **dependent eligibility requirements**



# Cost Changes

---

## Insignificant Cost Changes

- May automatically increase or decrease employees' contributions if:
  - The cost of a benefit changes during a period of coverage; and
  - Employees are required to make a corresponding change in their payments.

## Significant Cost Changes

- May permit mid-year election change if the cost charged to an employee for a qualified benefit significantly increases or decreases during plan year

# Coverage Changes

---

## Coverage changes

- Significant curtailment of coverage
- Addition or improvement of benefit package option
- Change in coverage of spouse or dependent under another employer plan
- Loss of certain other group health coverage (including CHIP coverage)
- Major life events (marriage, birth, adoption, employment changes)



## Special Rules

---

- Only some of the mid-year election change events apply to health FSAs
  - Change in status events apply
  - Cost and coverage changes do not apply
  - ACA changes do not apply
- Employees can prospectively change their HSA contribution election at any time during the plan year