

Legislative Brief

Health Care Reform: Simple Cafeteria Plans

EXECUTIVE SUMMARY

The Patient Protection and Affordable Care Act (PPACA) amends Section 125 of the Internal Revenue Code (the Code) to allow certain small employers to establish “simple cafeteria plans” for plan years beginning after **December 31, 2010**.

Under the new law, these small employers can take advantage of a safe harbor from certain nondiscrimination requirements applicable to cafeteria plans as long as the following are met:

- Eligibility requirements
- Participation requirements
- Minimum contribution requirements

The safe harbor would also cover the nondiscrimination requirements applicable to certain benefits offered under a cafeteria plan including group term life insurance, coverage under a self insured group health plan, and benefits under a dependent care assistance program.

This Fickewirth and Associates Legislative Brief summarizes the simple cafeteria plan as established by PPACA. Please read below for more detailed information.

SIMPLE CAFETERIA PLANS

What employers are eligible to establish a simple cafeteria plan?

An eligible employer is an employer with an average of 100 or fewer employees during either of the two preceding years. To meet this requirement, a year can only be taken into account if the employer was in existence throughout the year. An employer who was not in existence throughout the previous year must base this determination on the average number of employees it reasonably expects to employ in the current year.

In addition, once an employer meets this eligibility requirement and establishes a simple cafeteria plan for any year, the employer will continue to be treated as an eligible employer for subsequent years, until the year after the first year its average number of employees reaches 200 or more.

In defining who is the employer, the “employer” includes a predecessor of the employer, along with any companies that are required to aggregate under Code Sections 52(a) and (b), and Code Sections 414(n) and (o).

What are the minimum eligibility and participation requirements?

The requirements are met if all employees who had at least 1,000 hours of service for the preceding plan year are eligible to participate, and if all employees have the same election rights under the plan.

The employer may choose to exclude:

- Employees who have not attained age 21 before the close of the plan year
- Employees who have less than 1 year of service with the employer as of any day during the plan year
- Employees who are covered under a collective bargaining agreement in which cafeteria plan benefits were the subject of good faith bargaining

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- Nonresident aliens working outside the United States

Once an employee is eligible, he or she must be permitted to elect any benefit available under the plan, subject to any terms and conditions that are applicable to all participants.

What are the contribution requirements?

To establish a simple cafeteria plan, an employer must make a contribution on behalf of every "qualified employee," whether or not the qualified employee makes a salary deferral to the plan. A "qualified employee" includes any employee who is eligible to participate in the plan and who is not a highly compensated employee or a key employee.

The contribution may equal either:

- A uniform percentage (not less than 2 percent) of the employee's compensation for the plan year, or
- An amount not less than the lesser of:
 - 6 percent of the employee's compensation for the plan year, or
 - Twice the amount of the salary reduction contributions of each qualified employee.

If an employer decides to provide the matching contribution, it cannot provide a matching contribution to highly compensated or key employees at a rate greater than the matching contribution it provides to all other employees. The employer must use the same method to calculate the minimum contribution for all non-highly compensated employees. In addition, an employer can make contributions to provide additional qualified benefits under the plan, as long as the above requirements are met.

Which nondiscrimination testing is treated as being met?

Once an employer meets the contribution and eligibility requirements above, the plan is treated as meeting certain applicable nondiscrimination tests:

- The eligibility test in Code Section 125(b)(1)(A)
- The contributions and benefits test in Code Section 125(b)(1)(B)
- The key employee concentration test in Code Section 125(b)(2)
- The nondiscrimination requirements for group term life insurance in IRS Section 79(d)
- The requirements for self-insured medical expense reimbursement plans in IRS Section 105(h)
- The dependent care assistance requirements in IRS Section 129(d) paragraphs (2), (3), (4) and (8)

It is unclear at this point whether the safe harbor also applies to the health care reform requirement that fully insured group health plans must comply with under Code Section 105(h)(2) requirements. This requirement is found in Public Health Service Act (PHSA) Section 2716, which is not specifically mentioned in the simple cafeteria plan rules. The IRS has unofficially suggested that the safe harbor does apply to PHSA Section 2716; however, this information has not been documented in official guidance.

CONCLUSION

Simple cafeteria plans give certain eligible small employers a safe harbor advantage when it comes to nondiscrimination testing. This advantage results in savings on the administrative costs typically incurred in conducting this testing.

In addition, small employers who otherwise would not pass testing due to the lack of utilization by non-key and non-highly compensated employees will be able to establish cafeteria plans to enable their employees to use pretax dollars to purchase cafeteria plan benefits such as medical, vision and dental coverage.

This Fickewirth and Associates Legislative Brief is not intended to be exhaustive nor should any discussion or opinions be construed as legal advice. Readers should contact legal counsel for legal advice.