

Nondiscrimination in HRA and Cafeteria plans

Aimee Nash

September 8, 2009



Agenda

- Brief Introduction to HRAs and Cafeteria plans
- Nondiscrimination in HRA plan
- Nondiscrimination in Cafeteria plan



HRA plan defined

- HRA = Health Reimbursement Account
- Employer sponsored; no employee contributions; 213 expenses
- Non-taxable benefits under Code section 105 (nondiscrimination rules 105(h); 1.105-11)
- Carryover allowed
- Notice 2002-45/Rev Rul 2002-41 (establishes HRAs)



Cafeteria plan defined

- Code section 125 plan offers a choice between taxable benefits (cash) and qualified (non-taxed) benefits
- Qualified benefits:
 - Health plan excludible under Code section 105 & 106 (including FSA); 213 expenses
 - Group term life ins
 - Dependent care
 - Adoption assistance
 - 401(k) contributions
 - HSA contributions
- Use it or lose it (grace period); employee contributions allowed



Cafeteria plan nondiscrimination

- Cafeteria plan must meet 125; 1.125-7
- Qualified benefits must meet their own nondiscrimination rules
 - FSA/Health plan: Code section 105(h)
 - Group term life ins: Code section 79(d)
 - Dependent care: Code section 129(d)(2)
 - Adoption assistance : Code section 137(c)(2)





HRA/FSA nondiscrimination



HRA/FSA nondiscrimination Code section 105 requirements

- Eligibility: (must satisfy one of the following)
 - Benefits test
 - 70% of all employees benefit;
 - 80% of those eligible benefit if at least 70% are eligible
 - Benefits classification test: if plan only excludes a classification found not to be discriminatory in favor of HCEs (410(b)(1)(B) facts and circumstances test)
- Excludible employees:
 - Less than 3 years of service
 - Less than age 25
 - Part-time ees: 35 hr/wk; 9 m/yr (25 hr/wk; 7 m/yr)
 - CBA
 - NRA



HRA/FSA – section 105 continued

- Plan may not discriminate in favor of HCE
 - 5 highest paid officers;
 - Shareholder > 10%; or
 - 25% most highly paid (may exclude “excludible ees”)

- Benefits: If benefit offered to HCE, must be offered to all others
 - Maximum reimbursements must be uniform for all participants – may not be modified by age or years of service
 - If HCE are covered, maximum reimbursements may not be dependent on compensation
 - Plan may not discriminate in operation

- Nondiscrimination Failure:
excess reimbursement to HCEs taxable



HRA/FSA nondiscrimination example

PLR 8423036 (3/6/84)

- Facts:
 - All employees eligible to participate
 - Immediate eligibility for employees in group A
 - Group B employees eligible after 60 days
- Finding:
 - If any Group A employees are HCEs, any reimbursement occurring during first 60 days of employment will be excess reimbursement
- PLR also has another example of disparate benefits for HCEs and a determination of excess reimbursement





Cafeteria plan nondiscrimination



Cafe plan nondiscrimination section 125 requirements

Cafeteria plan may not discriminate in favor of

- Key Employee Participants (416(i)(1)) - prior plan yr
 - Officer w/ comp > \$160,000 (2009)
 - > 5% owner
 - > 1% owner with comp > \$150,000
 - Spouse, children, grandparents deemed to own
- Highly Compensated Participants
 - Officer (prior yr)
 - Shareholder > 5% (current or prior yr)
 - Highly compensated (414(q)(1)(B)) – prior plan yr
 - Comp > \$110,000 (2009)
 - Top paid group (20%)
 - Spouse or depend of the above



Section 125

Key employee nondiscrimination

- Key Employee nontaxable benefits must be $\leq 25\%$ all nontaxable benefits
- Example: Cafeteria plan offers all employees an election between taxable and qualified benefits.
 - 2 key employees each elect \$2,000 of qualified benefits
 - 4 non-key ees each elect \$2,000 of qualified benefits.
 - $4,000/12,000 = 25\%$
 - The qualified benefits are statutory nontaxable benefits.



Section 125 nondiscrimination excludible employees

- Excludible employees
 - < 3yrs of service if all require 3 yrs of service
 - CBA
 - NRA
 - COBRA participants



Section 125

HCE nondiscrimination - Eligibility

- Reasonable classification for exclusions and
- Ratio percentage test:
 - $\frac{[\#NHCE \text{ benefiting}/\#NHCE \text{ Elig}]}{[\#HCE \text{ benefiting}/\#HCE \text{ Elig}]}$
 - If $\#NHCE/\text{total ees}$ is 60% or less, the safe harbor ratio percentage = 50%
 - If greater than 60%, see chart in 1.410(b)-4(c)



Section 125; HCE nondiscrimination – Eligibility ----- Example

- 200 nonexcludable employees:
 - 120 NHCE
 - 80 HCE
- Plan benefits 60 NHCEs and 72 HCEs.
- Ratio percentage = 55.56%
 - $([60/120] / [72/80]) = 50\%/90\% = 0.5556$
- NHCE concentration 60% (120/200); safe harbor percentage is 50%
- Plan's ratio percentage is greater than the safe harbor percentage, the plan's classification satisfies the safe harbor



Section 125

HCE nondiscrimination - Benefits

- Benefits: total benefits, employer contributions, qualified benefits
 - Uniform election opportunity
 - Actual election may not be disproportionate
 - HCE participation may not exceed NHCE:
 - $HCE \text{ Benefits/comp} \leq NHCE \text{ benefits/comp}$
- Premium only plans do not need to meet the above benefits test (they must still meet the eligibility test)



FSA in Cafeteria plan fails nondiscrimination – 1.105-11(k)

- Corporation M maintains a cafeteria plan described in section 125 with an FSA component.
- Officer of the corporation elects to receive FSA reimbursements and the FSA fails the nondiscrimination rules
- The amount of excess reimbursement is taxable to the officer participating in the medical reimbursement plan.
- The FSA will be considered a taxable benefit under section 125 and the regulations thereunder.



Cafeteria plan fails nondiscrimination

- Key or HCE must include in gross income the value of the taxable benefit with the greatest value that the employee could have elected to receive even if employee elects only non-taxable benefits
- If salary deferral plan, wages are taxed.

