MEDICAL MUTUAL OF OHIO®
CAROLINA CARE PLAN | CONSUMERS LIFE

Healthcare re-FORUM

Healthcare Re-Forum : 2010 Issue No. 22

Simple Cafeteria Plans

The Patient Protection and Affordable Care Act of 2010 (PPACA) modified cafeteria plan regulations to create Simple Cafeteria Plans, which allow qualified employers with 100 or fewer employees to offer cafeteria plans as long as they meet minimum eligibility, participation and contribution requirements defined in the law. This change is effective for plan years beginning after December 31, 2010.

Prior to the passage of PPACA, IRS rules governing cafeteria plans did not include self-employed individuals in the definition of "employee." As a result, sole proprietors, partners, shareholders of 2 percent or more in S-corporations and members of limited liability companies were unable to participate in cafeteria plans. The PPACA created a "safe harbor" for qualified small employers from Internal Revenue Code Section 125, which prevents discrimination in favor of highly compensated employees for eligibility or specific qualified benefits. With Simple Cafeteria Plans, owners of small businesses may now participate as individuals, making it more likely they will offer these plans to their employees.

Other than this safe harbor provision and specific qualification provisions, cafeteria plans and Simple Cafeteria Plans are the same.

Types of Cafeteria Plans

Cafeteria plans enable employees to reduce their salaries on a pre-tax basis to pay for qualified benefits, thus reducing their overall tax liability. Qualified benefits include dependent care and healthcare benefits such as certain medications, health insurance premiums, copayments and deductibles.

There are three types of cafeteria plans, which apply to Simple Cafeteria Plans as well:

- **Premium-Only Plan (POP)** – In a POP, after-tax contributions made by employees to their employer-provided group insurance are converted to pre-tax contributions. This results in tax savings for both the employee (federal, FICA and sometimes state) as well as the employer (FICA and sometimes Workers' Compensation). This is the most commonly used type of cafeteria plan.
- **Flexible Spending Account (FSA)** – Employees may elect to deposit pre-tax earnings into an FSA to use for medical and/or dependent care expenses. FSAs function like a checking account in that the cafeteria plan administrator actually writes checks to reimburse participants for the medical and dependent care expenses they submit.
  - **Dependent care FSAs** – allow participants to pay up to $5,000 in qualified dependent care expenses using pre-tax dollars.
  - **Healthcare FSAs** – enable participants to fund individual accounts to use pre-tax dollars to pay for out-of-pocket healthcare expenses such as deductibles, coinsurance and fees for services that are not covered under their health insurance plans.
- **Full flex plan** – Through a full flex plan, employers can contribute a defined amount for benefits and employees can choose which benefits to purchase from a menu of options.

[over]

2060 East Ninth Street Cleveland, Ohio 44115-1355 Visit MedMutual.com.

Employers of all sizes can offer cafeteria plans. Most employers offer a POP because of the ease of establishing the plan and the available tax benefits. FSAs are popular with all types of employers, while only large employers (1,000+) typically offer full flex plans due to the increased administration and communication requirements.

Note: Many employers add FSAs or a full flex plan to the core POP to provide further tax-favored benefits for their employees.

Simple Cafeteria Plan Regulations

As defined by the PPACA, employers with 100 or fewer employees must meet the following minimum eligibility, participation and contribution requirements to qualify for a Simple Cafeteria Plan:

Eligibility

- Employers who averaged 100 or fewer employees in the previous two years can qualify for a Simple Cafeteria Plan. A company not in existence for the previous two years must reasonably expect to average 100 or fewer employees on business days during the current year.
- Special rules were created for a "growing employer." If the employee population exceeds 100 employees in the subsequent years, the employer can continue to sponsor a Simple Cafeteria Plan. However, once the employer exceeds 200 employees, the plan must be converted to another type of cafeteria plan to continue receiving tax advantages.
- Aggregation rules are used to prevent an employer from creating additional subsidiaries to avoid the limitation on the number of employees. In addition, leased employees have applicable regulations to calculate employer eligibility.

Participation

- Employees who worked at least 1,000 hours in the previous year must be eligible to participate.
- Every eligible employee must have the ability to elect any benefit available under the plan.
- Employees under age 21, employees who have yet to complete one year of service with the company and employees covered under a collective bargaining agreement may be excluded from participating.

Contributions

Plans will need to make qualified benefit contributions for eligible employees. The contribution amount must be determined based on one of the following calculations:

- A standardized percentage that is at least 2 percent of the employee's compensation; or
- An amount not less than the lesser of:
  (a) 6 percent of the employee's compensation for the plan year, or
  (b) an amount that is twice the amount of the salary reduction contributions of each qualified employee for the plan year.

If the employer relies on the satisfaction of (b), it will not be treated as compliant if the rate of contributions with respect to any salary reduction contribution of a highly compensated or key employee is greater than that of any other employee.

The IRS has provided a Frequently Asked Questions (FAQ) website for Cafeteria Plans, which is available at http://www.irs.gov/govt/fslg/article/0,,id=112720,00.html.

Employers should consult with their tax advisor before establishing a Simple Cafeteria Plan.

Future Topics:

- Rescissions
- Accountable Care Organizations
- Provisions Affecting Part-Time Employees
- Medical Loss Ratios