



R O B E R T B . S T E V E N S O N¹
N A N C Y K E P P E L M A N¹
N A N C Y J . S P E Z I A
T I M O T H Y J . M C G R A W
A N D R E W W . S T U M P F F²
D E B O R A H W . T H O M P S O N¹

O F C O U N S E L

N A N C Y H . W E L B E R , P . C .
A N T H O N Y S . H A R T I I I
R I C H A R D L . S A N D E R S O N , J R .
M I C K E Y B A R T L E T T

February 19, 2009

Cafeteria Plan Document and Nondiscrimination Regulations.

The proposed cafeteria plans were issued in August 2007 and were scheduled to be finalized and effective January 1, 2009. This did not happen, but we do expect the regulations to be finalized in 2009 with a possible effective date of January 1, 2010. The regulations require a written plan document and specify the contents of the written plan document. You should review or have your cafeteria plan document reviewed to ascertain compliance with the written plan document requirements.

The new proposed regulations define several key terms, including highly compensated individual or participant (consistent with the section 414(q) definition of highly compensated employee), officer, five percent shareholder, key employee and compensation.

The new proposed regulations set forth guidance for nondiscrimination tests that a cafeteria plan must satisfy, including descriptions of employees who are allowed to be excluded from testing, and a safe-harbor test for premium-only plans. These nondiscrimination tests are in addition to the nondiscrimination tests for the underlying component plans. For example, there are separate nondiscrimination tests for self-insured medical plans*, dependent care programs, and life insurance plans.

There are 3 general nondiscrimination tests relating to the overall cafeteria plan that must be satisfied under the proposed regulations, namely: (1) the Key Employee Concentration test; (2) the Eligibility test; and (3) the Contributions and Benefits test.

The Key Employee Concentration test states that if for any plan year, the qualified benefits provided to key employees exceed 25 percent of the aggregate of the qualified benefits provided for all employees through the cafeteria plan, each Key Employee includes in gross income an

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amount equaling the maximum taxable benefits that he or she could have elected for the plan year. Key Employee is defined in Code § 416(i).

The Eligibility test states that a cafeteria plan must not discriminate in favor of highly compensated individuals as to eligibility to participate for that plan year. A cafeteria plan does not discriminate in favor of highly compensated individuals if the plan benefits a group of employees who qualify under a reasonable classification established by the employer, as defined in Treas. Reg. § 1.410(b)-4(b), and the group of employees included in the classification satisfies the safe harbor percentage test or the unsafe harbor percentage component of the facts and circumstances test in Treas. Reg. § 1.410(b)-4(c). For purposes of the safe harbor percentage test and the unsafe harbor percentage component of the facts and circumstances test, the following employees are excluded from consideration –

- (A) Employees (except key employees) covered by a collectively bargained plan
- (B) Employees who are nonresident aliens and receive no earned income from sources within the United States; and
- (C) Former employees participating in the cafeteria plan under COBRA.

The Contributions and Benefits test provides an objective test to determine when the actual election of benefits is discriminatory. Specifically, the new proposed regulations provide that a cafeteria plan must give each similarly situated participant a uniform opportunity to elect qualified benefits, and that highly compensated participants must not disproportionately elect qualified benefits.

*Code § 105(h) applies to health FSA and self-insured health plans. Code § 105(h) provides that the exclusion provided by Code § 105(b) is not available with respect to certain amounts received by a highly compensated individual from a discriminatory self-insured health plan or a health FSAs.

THE TAKEAWAYS:

- **Have your plan document reviewed for written compliance, and**
- **Prepare to implement the nondiscrimination rules sooner, rather than later, in 2009.**