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WASHINGTON UPDATE

Health Care Reform Includes Safe Harbor Cafeteria Plan

by Brian H. Graff, Esq., APM

As of this writing, it is looking increasingly likely that the health care reform debate will not be completed by the end of 2009, notwithstanding the last-minute push by President Obama. What that likely means is that as you are reading this article, the debate is still ongoing and could continue quite possibly to the spring Congressional recess.

Regardless of your own views on health care reform, you should be aware that tucked into the Senate version of health care reform is a proposal by Senator Snowe (R-ME) that would create a new safe harbor for small business cafeteria plans as well as another critical change that would hopefully make cafeteria plans more attractive for small businesses. If enacted, the proposal would be effective beginning in 2011. Given that many ASPPA members work with cafeteria plans, we felt it important to highlight this issue.

Background

The proposal, which ASPPA's Government Affairs Committee helped develop, was included in legislation introduced by Senator Snowe [and co-sponsored by Senators Bingaman (D-NM) and Bond (R-MO)] called the SIMPLE Cafeteria Plan Act of 2009 (S. 988). Specifically, the proposal

would create a new "SIMPLE" cafeteria plan for small businesses, which would be exempt from the nondiscrimination requirements applicable to cafeteria plans if certain requirements were met. The safe harbor would also cover the nondiscrimination requirements applicable to certain benefits offered under the cafeteria plan, including group term life insurance, coverage under a self insured group health plan and benefits under a dependent care assistance program.

Presently, these nondiscrimination rules have been, to be frank, an unfair impediment on the utilization of cafeteria plans by small businesses. Take the key employee concentration test, for instance. That test requires that qualified benefits provided to key employees may not exceed 25 percent of the total of all benefits provided for all employees under the plan. Even if all an employer's employees participate in the plan, because of the way the test works, the plan may be considered discriminatory merely because there is a large number of owner-employees—fairly typical for a lot of small businesses. For example, if a company has three key employees, each of whom elects \$2,000 in nontaxable benefits, and seven non-key employees elect the exact same level of benefits (\$2,000), the plan will fail the test since 30 percent of the total benefits are going to key employees. $[(3 \times \$2,000) / (10 \times \$2,000) = 30\%]$ Simply put, this test discriminates against small businesses for being small.

Then there are the tests applicable to particular benefits. Dependent care benefits alone are subject to four different tests: (1) an eligibility test; (2) a contributions and benefits test; (3) the more than five percent owner concentration test; and (4) the 55 percent average benefits test. To demonstrate how these tests also discriminate against a small business for being small, let's look at the 55 percent average benefits test. Under this test, the average dependent care assistance benefit provided to all NHCEs must be at least 55 percent of the average benefit provided to all HCEs. The test operates very much like the ADP test applicable to 401(k) plans, including that nonexcludable NHCEs who do not participate are included in the test as a zero. For example, assume the same small business as above (the three key employees are the only HCEs). Two of the three HCEs contribute \$5,000 into the dependent care assistance program and two of the NHCE contribute \$5,000 into the dependent care assistance program. The plan would fail since the average benefit for NHCEs is only 43 percent of the average benefit for HCEs. $[(2 \times \$5,000/7)/(2 \times \$5,000/3) = 42.8\%]$ Rather than making sure cafeteria plan benefits are fairly distributed, these tests seem more designed to prevent small businesses from offering cafeteria plans in the first place.

SIMPLE Cafeteria Plan for Small Businesses

Under the proposal, cafeteria plans maintained by small businesses would be exempt from these onerous requirements if they meet certain minimum eligibility and participation requirements as well as minimum contribution requirements.

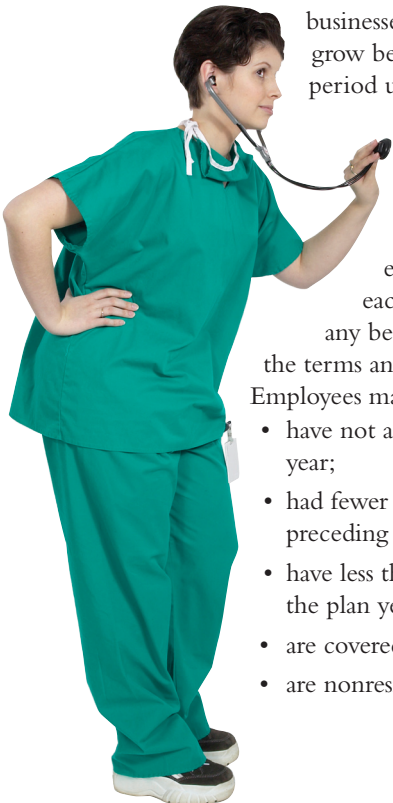
Eligible Employers

An employer is eligible to sponsor a SIMPLE cafeteria plan if, during either of the preceding two years, the small business employed on average 100 or fewer employees on business days. A transition rule applies for new businesses based on the number of employees the business is reasonably expected to employ. Also, businesses maintaining a SIMPLE cafeteria plan that grow beyond 100 employees will have a transition period until they exceed on average 200 or more employees. The usual controlled group rules apply in satisfying these rules.

Eligible Participants

To qualify, all otherwise not excludable employees must be eligible to participate, and each eligible employee must be able to elect any benefit available under the plan (subject to the terms and conditions applicable to all participants). Employees may be excluded if they:

- have not attained age 21 before the end of the plan year;
- had fewer than 1,000 hours of service during the preceding plan year;
- have less than one year of service as of any day during the plan year;
- are covered under a collective bargaining agreement; or
- are nonresident aliens.



Minimum Contribution Requirement

Like a 401(k) safe harbor plan, there are two alternative ways employers can satisfy the minimum contribution requirements that would apply to a SIMPLE cafeteria plan:

- The plan can provide flex-credits available for use during the plan year equal to at least two percent of each NHCE's compensation (regardless of any contributions made by NHCEs); or
- The value of employer-paid benefits under the plan are at least equal to two times the amount of the salary reduction contributions of NHCEs, but would not be required to be more than six percent of employee's compensation (*i.e.*, a 200 percent match up to six percent of pay).

Also like the 401(k) safe harbor, the rate of match for HCEs cannot be greater than the rate of match for NHCEs.

Allowing Self-employed Individuals to Participate in Cafeteria Plans

As you are aware, under current law "self-employed" individuals, such as sole proprietors, more than two percent shareholders in a Subchapter S corporation, members of a limited liability company and partners in a partnership are precluded from participating in a cafeteria plan. Since many small businesses are legally organized in a manner other than a traditional "C" corporation, this restriction is a major impediment to the use of cafeteria plans by small businesses. Further, there is simply no reasonable policy justification for excluding these small business owners merely due to the legal form of the business.

ASPPA's Government Affairs Committee is working to get this unreasonable restriction changed. We are hopeful that if the health reform legislation moves forward, it can be amended to finally allow business owners to participate in cafeteria plan just like other employees.

We will certainly continue to keep you apprised of these important developments. 



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