



## Compliance Reminders for Cafeteria Plans

The following general summary is intended to educate employers and plan sponsors on the potential effects of government guidance on employee benefit plans. This summary is not and should not be construed as legal or tax advice. As always, we strongly encourage employers and plan sponsors to consult competent legal or benefits counsel for all guidance on how the actions apply in their specific circumstances.

### Introduction

As benefits administration becomes more and more complicated, compliance is on everyone's to-do list. In the compliance world of never-ending change, the following is a refresher course for employers on three of the compliance requirements of Internal Revenue Code § 125 cafeteria plans that *haven't* changed: nondiscrimination testing, Form 5500 filing obligations, and Patient Centered Outcome Research Institute (PCORI) fees.

### What are Nondiscrimination Tests?

**The overall "25% Concentration Test"** compares all the pre-tax benefits elected by key employees with all the pre-tax benefits elected by non-key employees. Not more than 25% of the total benefits elected by all employees may be attributed to key employees.

#### Example:

All elections to the cafeteria plan add up to \$35,000. Of those total elections, key employee elections equal \$5,000. Key employee elections are about 14% of the total elections to the plan (i.e.,  $\$5,000 / \$35,000 = 14.3\%$ ). In this example, the cafeteria plan passes the 25% Concentration Test.

**The "55% Average Benefits Test"** involves only the dependent care portion of the cafeteria plan. The average dollar amount of benefits elected by non-highly compensated employees must be at least 55% of the average dollar amount of benefits elected by highly compensated employees.

#### Example:

Assume that highly compensated employees' elections are \$10,000 to the dependent care portion of the plan and there are five highly compensated employees in the company. Non-highly compensated employees elect \$19,500 to the dependent care portion of the plan and there are 13 non-highly compensated employees. The highly compensated average dollar amount is \$2,000 ( $= \$10,000 / 5$ ). The non-highly compensated average dollar amount is \$1,500 ( $= \$19,500 / 13$ ). The average dollar amount of benefits elected by non-highly compensated employees is 75% of the average dollar amount of benefits elected by highly compensated employees ( $\$1,500 / \$2,000$ ). In this example, the dependent portion of the cafeteria plan passes the 55% Average Benefits test.

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The “**5% Owner Test**” compares the dependent care benefits elected by more-than-5% owners of a company with dependent care benefits elected by non-owners. Not more than 25% of the total dependent care benefits elected by everyone in the dependent care benefit may be attributed to more-than-5% owners.

## Example:

Assume a \$5,000 election to the dependent care portion of the plan by a more-than-5% owner and elections in the amount of \$19,500 made by all non-owners. The more-than-5% owner's election is 20% of the total benefits elected to the dependent care portion of the plan ( $20\% = \$5,000 / (\$24,500 [= \$5,000 + 19,500])$ ). In this case, the dependent care portion of the plan passes the 25% Owner test because only 20% of the dependent care benefits were elected by the more-than-5% owner.

The “**Eligibility, Benefits Available, and Contribution and Benefits**” Tests ensure that employers offer all benefits to an adequate number of employees and benefits do not discriminate in favor of highly compensated or key employees.

In the event the cafeteria plan does not meet all the nondiscrimination requirements, employers may need to change benefit elections and payroll amounts to bring the plan into compliance. It is important to test prior to the end of the cafeteria plan year. If testing is completed after the end of the plan year, it's too late to take corrective action. Instead of reducing key or highly compensated elections in order to pass the nondiscrimination test(s), the affected employees would be taxed on their total election amount.

## Form 5500 Obligation

A frequently overlooked responsibility for cafeteria plan sponsors is Form 5500 filings under certain circumstances. In 2002, IRS Notice 2002-24<sup>1</sup> suspended the filing requirement imposed on cafeteria and fringe benefit plans. However, don't be misled! The filing requirement for welfare benefit plans remains unchanged.

### What is a welfare benefit plan?

Welfare benefit plans provide benefits such as medical, dental, life insurance, apprenticeship and training, scholarship funds, severance pay and disability. Health Flexible Spending Accounts (FSAs) contained inside cafeteria plans and Health Reimbursement Arrangements (HRAs) qualify as welfare benefit plans.

### Who must file a Form 5500?

Employers that sponsor welfare benefit plans covered by Title I of the Employee Retirement Income Security Act of 1976 (ERISA), with 100 or more participants at the beginning of the plan year, are required to file a Form 5500 for those plans. However, there are a couple of exceptions that apply, depending on the type of employer sponsoring the plan.

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<sup>1</sup> <https://www.irs.gov/pub/irs-drop/n-02-24.pdf>

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A general exception applies to:

- a governmental plan; or
- a church plan under ERISA § 3(33).

The plan *may* not be exempt from filing if:

- it is deemed to have plan assets;
- plan funds are separated from the employer's general assets;
- plan funds are held in trust; or
- plan funds are forwarded to a Third-Party Administrator.

Most non-exempt employer plans will complete all questions on Form 5500. Depending on the funding arrangement or payments from the plan, attaching Schedules may be applicable.

Since 2009, however, the "Instructions for Form 5500" were modified to make clear that plans that are paid from the general assets of the employer need not file Schedule C.

## When does a welfare benefit plan need to file a Form 5500?

Forms must be filed by the last day of the seventh calendar month after the end of the plan year. A plan may obtain a one-time extension of time to file. Form 5558 must be sent by the original due date in order to gain a 2½ month extension of time in which to complete and file the Form 5500.

## PCORI Fees

The Affordable Care Act created the Patient-Centered Outcomes Research Institute (PCORI), a non-profit institute charged with assisting in clinical effectiveness research. To aid in the financial support for this endeavor, certain health insurance carriers and health plan sponsors are required to pay fees based on the average number of lives covered by welfare benefits plans. These fees are referred to as PCORI or Clinical Effectiveness Research (CER) fees.

The applicable fee for plan years ending on or after October 1, 2021 and before October 1, 2022 is \$2.79.

Fees are reported and paid annually through IRS Form 720 (Quarterly Federal Excise Tax Return). These fees are due by July 31 of the year following the end of the plan year along with IRS Form 720.

Indexed each year, the fee amount is determined by the value of national health expenditures. The fee phases out for plan years ending after September 30, 2029.

As a reminder, fees are required for all group health plans including HRAs but are not required for FSAs that are considered excepted benefits. To be an excepted benefit, health FSA participants must be eligible for their employer's group health insurance plan and may include employer contributions in addition to employee salary reductions. However, the employer contributions may only be \$500 per participant or up to a dollar-for-dollar match of each participant's election.

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HRAs exempt from other regulations would be subject to the CER fee. For instance, an HRA that only covered retirees would be subject to this fee, but those covering dental or vision expenses only would not be, nor would employee EAPs, disease management programs and wellness programs be required to pay CER fees.

## Closing

Compliance becomes clearer for employers through knowledge. It's as easy as contacting HealthEquity for more information about its services, or your own accounting or legal sources for additional guidance.

Speak with your HealthEquity contact(s) if you would like HealthEquity to complete nondiscrimination testing or Form 5500 services for your FSA plan.