

Establishment of SIMPLE Cafeteria Plans for Small Businesses in the Patient Protection and Affordable Care Act

(Adapted from Joint Committee on Taxation (JCX-18-10), March 21, 2010)

Present Law

If an employee receives a qualified benefit (as defined below) based on the employee's election between the qualified benefit and a taxable benefit under a cafeteria plan, the qualified benefit generally is not includable in gross income. However, if a plan offering an employee an election between taxable benefits (including cash) and nontaxable qualified benefits does not meet the requirements for being a cafeteria plan, the election between taxable and nontaxable benefits results in gross income to the employee, no matter what benefit is elected and when the election is made. A cafeteria plan is a separate written plan under which all participants are employees, and participants are permitted to choose among at least one permitted taxable benefit (for example, current cash compensation) and at least one qualified benefit. Finally, a cafeteria plan must not provide for deferral of compensation, except as specifically permitted in sections 125(d)(2)(B), (C), or (D) of the Internal Revenue IRC (IRC).

Qualified benefits

Qualified benefits under a cafeteria plan are generally employer-provided benefits that are not includable in gross income. Examples include employer-provided health insurance coverage, group term life insurance coverage not in excess of \$50,000, and benefits under a dependent care assistance program. In order to be excludable, any qualified benefit elected under a cafeteria plan must separately satisfy any requirements under the IRC section that provides the exclusion. However, some employer-provided benefits that are not includable in gross income under an express provision of the IRC are explicitly not allowed in a cafeteria plan. These benefits are generally referred to as nonqualified benefits. Examples of nonqualified benefits include scholarships; employer provided meals and lodging; educational assistance; and fringe benefits. A plan offering any nonqualified benefit is not a cafeteria plan.

Employer contributions through salary reduction

Employees electing a qualified benefit through salary reduction are choosing to give up salary and instead to receive a benefit that is excludible from gross income because it is provided by employer contributions. Section 125 provides that the employee is treated as receiving the qualified benefit from the employer in lieu of the taxable benefit. For example, active employees participating in a cafeteria plan may be able to pay their share of premiums for employer provided health insurance on a pre-tax basis through salary reduction.

Nondiscrimination requirements

Cafeteria plans and certain qualified benefits (including group term life insurance, self-insured medical reimbursement plans, and dependent care assistance programs) are subject to

nondiscrimination requirements to prevent discrimination in favor of highly compensated individuals generally as to eligibility for benefits and actual contributions and benefits provided. There are also rules to prevent the provision of disproportionate benefits to key employees through a cafeteria plan. Although the basic purpose of each of the nondiscrimination rules is the same, the specific rules for satisfying the relevant nondiscrimination requirements, including the definition of highly compensated individual, vary for cafeteria plans generally and for each qualified benefit. An employer maintaining a cafeteria plan in which any highly compensated individual takes part must make sure that both the cafeteria plan and each qualified benefit satisfies the relevant nondiscrimination requirements. Otherwise, a failure to satisfy the nondiscrimination rules generally results in a loss of the tax exclusion by the highly compensated individuals.

New PPACA Provision / Safe Harbor (Sec. 9022 of the PPACA; Sec. 125 of IRC)

Effective January 1, 2011, an eligible small employer is provided under the new health reform law with a safe harbor from the nondiscrimination requirements for cafeteria plans as well as from the nondiscrimination requirements for specified qualified benefits offered under a cafeteria plan, including group term life insurance, benefits under a self insured medical expense reimbursement plan, and benefits under a dependent care assistance program. Under the safe harbor, a cafeteria plan and the specified qualified benefits are treated as meeting the specified nondiscrimination rules if the cafeteria plan satisfies minimum eligibility and participation requirements and minimum contribution requirements.

Eligibility requirement

The eligibility requirement is met only if all employees (other than excludable employees) are eligible to participate, and each employee eligible to participate is able to elect any benefit available under the plan (subject to the terms and conditions applicable to all participants).

However, a cafeteria plan will not fail to satisfy this eligibility requirement merely because the plan excludes employees who

1. have not attained the age of 21 (or a younger age provided in the plan) before the close of a plan year,
2. have fewer than 1,000 hours of service for the preceding plan year,
3. have not completed one year of service with the employer as of any day during the plan year,
4. are covered under an agreement that the Secretary of Labor finds to be a collective bargaining agreement if there is evidence that the benefits covered under the cafeteria plan were the subject of good faith bargaining between employee representatives and the employer, or
5. are described in IRC section 410(b)(3)(C) (relating to nonresident aliens working outside the United States).

An employer may have a shorter age and service requirement but only if such shorter service or younger age applies to all employees.

Minimum Contribution Requirement

The minimum contribution requirement is met if the employer provides a minimum contribution for each nonhighly compensated employee (employee who is not a highly compensated employee or a key employee (within the meaning of section 416(i))) in addition to any salary reduction contributions made by the employee.

The minimum must be available for application toward the cost of any qualified benefit (other than a taxable benefit) offered under the plan. The minimum contribution is permitted to be calculated under either the nonelective contribution method or the matching contribution method, but the same method must be used for calculating the minimum contribution for all nonhighly compensated employees.

The minimum contribution under the nonelective contribution method is an amount equal to a uniform percentage (not less than two percent) of each eligible employee's compensation for the plan year, determined without regard to whether the employee makes any salary reduction contribution under the cafeteria plan. The minimum matching contribution is the lesser of 100% of the amount of the salary reduction contribution elected to be made by the employee for the plan year or (2) six percent of the employee's compensation for the plan year. Compensation for purposes of this minimum contribution requirement is compensation with the meaning of section 414(s).

A simple cafeteria plan is permitted to provide for the matching contributions in addition to the minimum required but only if matching contributions with respect to salary reduction contributions for any highly compensated employee or key employee are not made at a greater rate than the matching contributions for any nonhighly compensated employee. Nothing in the new provision prohibits an employer from providing qualified benefits under the plan in addition to the required contributions.

Eligible Employer

An eligible small employer under the provision is, with respect to any year, an employer who employed an average of 100 or fewer employees on business days during either of the two preceding years. For purposes of the provision, a year may only be taken into account if the employer was in existence throughout the year. If an employer was not in existence throughout the preceding year, the determination is based on the average number of employees that it is reasonably expected such employer will employ on business days in the current year. If an employer was an eligible employer for any year and maintained a simple cafeteria plan for its employees for such year, then, for each subsequent year during which the employer continues, without interruption, to maintain the cafeteria plan, the employer is deemed to be an eligible small employer until the employer employs an average of 200 or more employees on business days during any year preceding any such subsequent year.

The determination of whether an employer is an eligible small employer is determined by applying the controlled group rules of sections 52(a) and (b) under which all members of the controlled group are treated as a single employer. In addition, the definition of employee includes leased employees within the meaning of sections 414(n) and (o).