



## For Your Benefit.

### **New Simple Cafeteria Plans**

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The health care reform act, better known as the Patient Protection and Affordable Care Act of 2010 (PPACA), enacted a new form of cafeteria plan that is available to small employers starting in 2011.

Modeled after the Simple 401(k) and Simple IRA plans, the new Simple cafeteria plan likewise provides certain protections for eligible small employers from the onerous nondiscrimination rules that many small employers failed due only to their size.

For example, imagine a small three employee organization named ABC with one owner, Ms. B. In order to even be eligible to participate in her own cafeteria plan, the organization has to be a “regular” or C corporation. All three employees, including Ms. B, were offered and elected family health coverage through ABC’s plan. ABC pays 90 percent of the premiums and the employees each contributed 10 percent on a pre-tax basis through a Section 125 premium conversion program. That’s the entire plan. It certainly doesn’t appear to be discriminatory, but under current IRS rules it fails an important nondis-

crimination test under Section 125 known as the Concentration Test. Under that test, a key employee (in this case, Ms. B) cannot receive more than 25 percent of the total pre-tax benefit within the plan. In our example, she receives 33.33 percent of the pre-tax benefit, thus failing the test—solely because ABC is too small, not because it is doing anything discriminatorily in either eligibility, benefits, or contributions.

Many in Congress saw this as unfair to small employers, and in a bipartisan effort ensured that the new Simple cafeteria plan provisions addressed this and other nondiscrimination issues.

#### ***The Simple Cafeteria Plan***

If an eligible small employer meets certain requirements, it may optionally adopt a Simple cafeteria plan. In exchange, the plan is deemed to automatically pass the nondiscrimination requirements of not just Section 125 of the Internal Revenue Code, but many of the individual plan type’s nondiscrimination rules as well.

The requirements to adopt a Simple cafeteria plan are:

1. The employer must have employed on average 100 or fewer employees during either of the prior two years. For a

new employer, eligibility is based upon the number of employees the employer is reasonably expected to employ. All controlled group and affiliated service group employers are aggregated as one employer for purposes of determining if the employer meets the “100 or fewer employees” test. Further, a growing small employer may continue to maintain an existing Simple cafeteria plan if it expands beyond 100 employees through the end of the plan year in which it reaches 200 employees, as long as the plan was established while the employer met the “100 or fewer employees” rule.

2. All non-excludable “qualified” employees who had at least 1,000 hours of service during the previous plan year must be eligible to participate in the Simple cafeteria plan. However, those who do not have 1,000 hours of service in the current plan year can also be excluded. The term “qualified employee” means any employee who is not highly compensated (using the same definitions as found for qualified retirement plans) or a key employee and who is eligible to participate in the plan. Highly compensated and key employees are allowed

to also participate in the plan, but may not have eligibility or benefits that discriminate in their favor.

The plan may exclude certain employees who:

- Have not attained age 21 (or any younger age provided in the plan) before the end of the 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 non-resident aliens

The employer can have a shorter age or service requirement, but only if it applies to all employees.

3. Each eligible employee must be able to elect any benefit under the plan under the same terms and conditions as all other participants.

### ***Minimum Contribution Requirements***

In order to meet the requirements of a Simple cafeteria plan, the employer must make a minimum contribution

that an eligible participant could use towards any benefit within the plan.

The employer's minimum contribution for all nonhighly compensated employees must be at least either:

1. A uniform employer contribution percentage of at least two percent of compensation whether or not the employee makes salary reduction contributions to the plan; or
2. A matching contribution of the lesser of a 200 percent of the employee's contribution or six percent of the employee's compensation. Additional employer contributions can be made, but the rate of any matching contribution for highly compensated employees or key employees cannot be greater than the rate of match for nonhighly compensated employees.

On a practical basis, most small employers offering a health plan through the Simple cafeteria plan and subsidizing a significant portion of that health plan would in most cases be making a contribution to the that is substantially more than one of the

minimum levels (six percent of compensation).

While regulations implementing these new plans are not yet published as of the date of this writing, we expect that a nonhighly compensated employee who did not elect any benefits under the plan would not require any employer contribution, since—as in the retirement plan arena—the employer has technically matched 200 percent of the employee's contribution.

### *Summary*

For “regular” or C corporations meeting the employee size requirements, we expect Simple cafeteria plans to be an excellent benefit delivery tool beginning in 2011. For sole proprietors, partnerships, LLCs, S corporations, and other non-C corporations, they may still establish a Simple cafeteria plan for their employees, but the owners/shareholders are, under current rules (barring a favorable result in the forthcoming IRS regulations) ineligible to participate in their own plan.

Nevertheless, eligible small employers should be exploring these new plans.

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