

Employee  
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# Cafeteria Plan Basics



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## Cafeteria Plan Basics

- What it is
- Why have one
- Eligible accounts
- Basic regulations
- Health Care FSAs
- Dependent Care FSAs
- Individual Premium FSAs



## What it is

# What it is

- **A Cafeteria Plan**
  - Choice between tax-free benefit and taxable compensation
  - Allows tax-free deductions for certain benefits
  - Allows taxable extra pay for waiving certain benefits
- **Section 125 Plan**
  - IRS regulation that governs
- **Flexible Spending Arrangements**
  - Accounts “created” by Cafeteria Plan



Why have one

# Why have one

- **Allows employees to choose among benefits**
  - Insurance premiums pre-tax
  - Taxable cash for waiving benefit
  - HSA contributions pre-tax
  - Elections for pre-tax Flexible Spending Accounts (FSAs)
- **No plan = taxation**
  - Employee taxes (W-2)
  - Employer taxes



# Why have one

- **Tax savings**
  - Employee (about 30% total)
    - FICA
    - FUTA
    - Federal and state withholding taxes
  - Employer
    - FICA (7.65% of pre-tax elections)
    - FUTA
- **Employer's savings can offset administrative fees**



## Eligible accounts

# Eligible accounts

- **Plans**
  - Insured (insurance company pays claims)
  - Self-funded (employer pays claims)
- **Eligible**
  - Premiums (insured or self-funded)
  - Health Savings Account (HSA) contributions
  - FSAs
  - Paid Time Off buy/sell

# Eligible accounts

- **Ineligible**
  - Educational assistance
  - Transportation
  - Health Reimbursement Arrangements
  - Medical Savings Accounts
  - Retirement (other than 401(k))

# Eligible accounts

- **Eligible premiums**

- Examples:

- **Medical (group plan)**
    - **Dental**
    - **Vision**
    - **Prescription drug**
    - **Disability**
    - **Group term life (up to \$50,000 coverage for employee only)**
    - **AD&D**
    - **Specific disease policies**

# Eligible accounts

- **Ineligible premiums**
  - Examples:
    - Spouse or dependent group term life
    - Employee group term life exceeding \$50,000 in coverage
    - Individual medical insurance
    - Long term care
- **Eligible HSA Contributions**
  - HSA in employee's name

# Eligible accounts

- **Ineligible HSA contributions**
  - HSA in spouse or dependent's name
- **Eligible FSAs**
  - Health Care FSA  
(standard, limited, post-deductible)
  - Dependent Care FSA
  - Individual Premium FSA
  - Adoption Assistance FSA
- **Paid Time Off buy/sell**



## Basic regulations



# Basic regulations

- **Plan Document**
  - Employer document
  - Defines plan operation
    - **Examples:**
      - Is premium automatically pre-tax unless employee states they wish to pay post-tax or is it separately elected?
      - Does the plan allow all Permitted Election Changes?

# Basic regulations

- **SPD**

- Employee document
- Defines plan operation (less detail)
- Defines available accounts
- Defines 12-month plan year
- Defines FSA eligibility (at minimum)
- Denotes FSA election maximums (at minimum)
- Denotes other features of plan (cash-in-lieu)
- Denotes other features of plan (FSA grace, rollover, runout)

# Basic regulations

- **Election made prior to plan start**
  - Enrollment form signed
  - Delay in receipt is acceptable
  - New hires
    - **Signed prior to coverage eligibility date**
    - **Exception if effective on date of hire – typically 30 days to enroll**
    - **Election is effective on eligibility date**

# Basic regulations

- **Election for entire plan year**
- Election cannot be changed except under certain circumstances (Permitted Election Changes)
  - **Add coverage without event, deductions must be post-tax**
  - **Drop coverage without event, cannot stop pre-tax deductions**

# Basic regulations

- **Election deducted pre-tax and becomes employer funds to purchase benefits**
  - Non-refundable
  - No longer employee's money
- **Funds not used are forfeited (use-it-or-lose-it)**
  - Over-elect and don't get money back
  - Insurance company/employer keeps funds even if claims do not equal or exceed premiums

# Basic regulations

- **Must pass plan year-end nondiscrimination testing**
- **Self-employed individuals cannot participate**
  - Based on how company files taxes
  - Partnership: All owners (partners)
  - Sole-proprietorship: the owner
  - Subchapter S Corporation
    - **All more than 2% shareholders**
    - **Spouses of more than 2% shareholders**
    - **Lineal ascendants/descendants of more than 2% shareholders**



## Health Care FSAs

# Health Care FSAs

- **Self-funded health plan**
- **Section 105 Plan**
  - IRS regulation that governs
- **Tax-free reimbursement of eligible health expenses**
  - Medical
  - Dental
  - Vision



# Health Care FSAs

- **HIPAA applies**
- **Uniform Coverage rule applies**
  - Risk to employer
  - Entire annual election available day one
  - Cannot ask participant to repay or accept repayment for mid-year expenses incurred prior to termination date
- **COBRA applies**
- **FMLA applies**

# Health Care FSAs

- **Forfeiture procedure must be detailed in Plan Document**
  - Example
    - **First offset overspent accounts**
    - **Second offset plan fees**
    - **Finally, choose one option**
      - Disburse to participants as taxable income on an equal or weighted basis
      - Disburse equally to participants as extra funds for next year
      - Keep the forfeiture

# Health Care FSAs

- **Eligible expenses defined under Section 213 (d)**
  - Insurance premiums not allowed
  - Long-term care expenses not allowed
  - Participant, spouse, eligible child, or dependent expenses allowed
  - Must be incurred during plan year (sans grace period or carryover)
  - Must be submitted during plan year (sans runout)
  - Substantiating data must come from a third-party
  - Participant must agree to reimbursement and certify it is out-of-pocket and will not be claimed as a tax deduction

# Health Care FSAs

- **Maximum employee contribution is \$2,650**
  - Limit on pre-tax employee deductions per 12 month plan year
  - Short plan year limit is pro-rated
  - Limit per employer (controlled group rules apply)
    - **Employee changes jobs, can elect \$2,650 at each job**
    - **Employee has two jobs, can elect \$2,650 at each job**
    - **No family maximum**
  - Employer contributions not subject to limit

# Health Care FSAs

- **Excepted Health Care FSA**
  - Health Care FSA participants must be eligible for group medical plan
  - Employer does not contribute more than
    - **\$500 or**
    - **The employee contributes**

# Health Care FSAs

- **COBRA applies**
  - Limited obligation for Excepted Health Care FSAs
    - **Only until end of plan year**
    - **Only if account is not overspent**
      - Remaining deposits > Remaining balance = Overspent
  - Standard obligation for non-Excepted Health Care FSAs
    - **Standard COBRA period**
    - **Must allow to enroll in next plan year**
    - **Offer even if account is overspent**

# Health Care FSAs

- **Form 5500 Reporting**
  - Required if 100 or more participants on first day of plan year
  - May file as part of a Wrap Plan or alone
    - **Due seven months following end of plan year**
    - **Standard two and a half month extension**
    - **Special extensions granted on case-by-case basis**
  - Must distribute Summary Annual Report (SAR) if Form 5500 filed
    - **Due nine months following end of plan year or**
    - **Within two months following extended deadlines**



## Dependent Care FSAs



# Dependent Care FSAs

- Dependent care assistance program
- **Section 129 Plan**
  - IRS regulation that governs
- **Tax-free reimbursement of eligible daycare expenses**
- HIPAA DOES NOT apply
- **Uniform Coverage rule DOES NOT apply**
- COBRA DOES NOT apply
- **FMLA DOES NOT apply**

# Dependent Care FSAs

- **Forfeiture procedure must be detailed in Plan Document**
  - Example
    - **First offset plan fees**
    - **Finally, choose one option**
      - Disburse to participants as taxable income on an equal or weighted basis
      - Disburse equally to participants as extra funds for next year
      - Keep the forfeiture

# Dependent Care FSAs

- **Eligible expenses**
  - Care must be for a qualifying person
  - Care must be custodial care to allow participant and spouse to work, look for work or go to school full-time
  - Provided by individual who claims as taxable income and cannot be participant's dependent or child under age 19
  - Costs for food, clothing, education, transportation, supplies and overnight care are not eligible
  - Must be incurred during plan year (sans grace period)
  - Must be submitted during plan year (sans runout)

# Dependent Care FSAs

- **Eligible expenses**
  - Substantiating data must come from a third-party
  - Participant must agree to reimbursement and certify it is out-of-pocket and will not be claimed as a tax deduction
  - If employee is divorced or separated from other parent
    - **Parent that has custody majority of nights during the year**
    - **Parent who has higher adjusted gross income if 50/50 custody**
  - If employee is not married to other parent, but co-habiting, then parent claiming the child as a dependent on taxes

# Dependent Care FSAs

- **Maximum household contribution/reimbursement varies**
  - Limit on pre-tax household deductions per tax year
    - Employee married filing jointly or filing head of household - \$5,000
    - Employee married filing separately - \$2,500
    - Employee's earned income if less than \$5,000/\$2,500
    - Employee's spouse's earned income if less than \$5,000/\$2,500
    - Employee's spouse is full-time student - \$250 per month for 1 child or \$500 per month for 2 or more children



## Individual Premium FSAs

# Individual Premium FSAs

- **Tax-free reimbursement of eligible premiums**
  - Individual insurance for employee, spouse or dependents
  - Dental, vision, specific disease and disability
- **HIPAA does apply**
- Uniform Coverage rule **DOES NOT** apply
- **COBRA DOES NOT** apply
- **FMLA DOES NOT** apply

# Individual Premium FSAs

- **Forfeiture procedure must be detailed in Plan Document**
  - Example
    - **First offset plan fees**
    - **Finally, choose one option**
      - Disburse to participants as taxable income on an equal or weighted basis
      - Disburse equally to participants as extra funds for next year
      - Keep the forfeiture



# Individual Premium FSAs

- **Eligible expenses**
  - Medical insurance premiums not allowed
  - Participant, spouse, eligible child, or dependent non-medical insurance premiums allowed
  - Must be incurred during plan year (sans grace period)
  - Must be submitted during plan year (sans runout)
  - Substantiating data must come from a third-party
  - Participant must agree to reimbursement and certify it is out-of-pocket and will not be claimed as tax deduction

# Questions?

- Any questions can be addressed by e-mail or phone at your convenience

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