

## **Fundamentals of Nondiscrimination Testing - Webinar Q&A**

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*The following questions were asked during the two webinar sessions in September 2019:*

### **General Presentation Questions**

**Q: Can you define self-funded health plan and how that differs from where a company pays premiums to an insurance company?**

A: A self-funded health plan is where the plan sponsor (generally the employer) bears the risk of providing the plan and paying for claims instead of an insurance company. The employer generally contracts with an administrator or carrier to administer the claims processing as well as the network access, but the employer themselves pay for the claims incurred rather than a set premium. In addition, many self-funded employers will chose to purchase stop loss insurance for catastrophic claim protection.

So the plan sponsor would keep any employee-collected premiums and then reimburse claims out of those funds.

If the claims exceed the funds on hand, the plan sponsor would be responsible to come up with the difference to reimburse those claims and if the funds on hand exceed the claims, the plan sponsor would be responsible to keep those funds protected for reimbursement of future eligible claims.

For an insured plan, the insurance company has those responsibilities and bears the risks and responsibilities for those plan assets.

Keep in mind, a self-funded health plan could be a self-funded major medical plan, self-funded dental or vision plan, a health reimbursement arrangement (HRA) or a health flexible spending account (FSA).

**Q: How is day-to-day authority defined?**

A: All business types will have someone that has day to day authority to act on behalf of the business. Examples of individuals who generally have day-to-day authority are listed on slide 14. Generally, this is an individual who holds the title of CEO, President, COO, Director, Manager,

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Superintendent, Administrator or someone who performs the duties generally associated with an individual who holds those sorts of titles.

**Q: What if we pay someone's health premium 100%?**

A: Health premiums that are paid for 100% by the employer are not technically part of the cafeteria plan since there is no pre-tax payroll deduction associated with the premium. Therefore, these premiums should not be included in the testing calculations.

Please note, however, that if someone has dependents on their plan, then the additional cost for those dependents' coverage is part of that employee's health premium. So, if the employer only pays for the employee's portion of the health premium, but the employee pays pre-tax for the additional cost to have those dependents on the coverage, then this means that the health premium is not paid 100% by the employer and would therefore need to be included in its entirety.

**Q: What happens if the plan fails when we test? Do we discontinue the plan?**

A: Whether you choose to take an action such as discontinuing the plan depends on the extent to which the plan failed and how impactful it is to rectify the failure.

When a plan fails, the regulation indicates that the individuals who were considered to be highly compensated for that test would be taxed on the benefit they received from the plan.

So, if the Section 129 test fails, then the individuals who were highly compensated for that test would have to be taxed on their Dependent Care FSA. If the only participant in this plan is a highly compensated individual, then discontinuing to offer the benefit may make sense. But if there are 100 participants in the plan who are not affected by the failure and only 1 participating highly compensated individual who is, then perhaps simply discontinuing to allow the highly compensated individual to participate is a more appropriate response.

**Q: Does it matter what time period (month) you use?**

A: When Employee Benefits Corporation collects information regarding cafeteria plan monthly premiums and HSA contributions, we only ask our clients to provide one month of data. We then use that month to calculate a year's worth by multiplying that figure out by 12. This is to reduce the hardship on our clients to provide data, but also to ensure we can test the plan prior to the end of the plan year so that we can provide clients with options to avoid failure, or, when that is not possible, time to process the tax adjustments required to comply.

Due to this methodology, we request that a month that is typical of what a normal month was for your plan year, so that when we multiply that figure by 12 we end up with a total that is close to what you would have if you were to add every month of the plan year together.

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**Q: For Officer, would that include the C-suite of Officers or just the 1-2 top Officers?**

A: How many individuals to list as officers really depends on how your organization is structured. Some organizations have many C-suite officers, but only one of them has day-to-day authority over the operations and therefore they would only list that one person. Others operate more collaboratively and would therefore list more. It, unfortunately, is an analysis that is very dependent on the particular situation.

**Q: Do you have to complete the test every year, even if you have been tested before and nothing has changed? Or can you just complete the forms?**

A: A cafeteria plan must not discriminate in favor of highly compensated individuals as to eligibility to participate and utilization for that plan year. Generally at least one thing changes each and every year since the test is dependent upon election amounts, individuals employed, and compensation.

According to Section 125 regulations, nondiscrimination testing must be performed as of the last day of the plan year, taking into account all non-excludable employees (or former employees) who were employees on any day during the plan year.

**Q: If we offer STD & LTD to only Managers/Supervisors would that possibly cause you to FAIL?**

A: The only way that this would cause the Section 125 Contributions and Benefits Availability Test to fail is if all of your managers and supervisors are highly compensated employees under the Section 125 definition and if they pay for those benefits on a pre-tax basis.

If some of your managers and supervisors are not highly compensated employees, then these benefits are offered to non-highly compensated employees as well and if these are not pre-tax employee-paid benefits, then they are not part of the cafeteria plan and wouldn't be looked at in that test.

**Q: If the 100% owner has medical insurance and it is paid for 100% by the company would that cause you to FAIL?**

A: Under the Affordable Care Act there was the intention to test insured plans beginning in 2011. Currently, the testing of insured health plans is not begin enforced, pending any further guidance from the IRS. The only place where insured medical insurance premiums are tested are under the Section 125 regulations and since the owner's medical insurance is not part of the cafeteria plan, this does not cause a failure.

**Q: Do we include temps?**

A: Temporary employees would be included if they would be considered your common law employees. This is definitely the case if your organization will provide that individual with a W-2

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for the year.

If, however, you contract with a temp agency to provide your temporary employees and they are therefore not receiving a W-2 from your organization, it is a bit more difficult to determine if they would be considered your common law employee. We would recommend seeking legal counsel if you need assistance with this determination.

**Q: What do I include for compensation for an employee if they did not work the full year in 2018? Example is somebody who started in November of 2018.**

A: Individuals who are hired in the middle of a compensation reporting period would only have a partial year's worth of compensation included.

So for a plan reporting compensation from January 1, 2018 to December 31, 2018, an individual hired in November would only have two months' worth of compensation included in the testing.

**Q: How do you know if you have a cafeteria plan or not?**

A: The cafeteria plan is a legal term that would mean you offer your employees the choice between cash or qualified benefits which are tax free. The IRS requires that you have a written plan document and meet other IRS compliance requirements. Examples of qualified benefits that can be paid for from employees paychecks pre-tax would include certain insurance premiums (ie. health, dental, vision, etc.), health savings accounts (HSA) contributions or health care or dependent care flexible spending accounts.

So if your organization allows any of these, then your organization should have a cafeteria plan.

**Q: If an employer pays 100% for full time employees but part-time employees need to pay a portion of their premiums would only the part-time employee premiums be included?**

A: Yes, since 100% employer-paid premiums are not part of the cafeteria plan, the full-time employee premiums would not be included in this situation.

**Q: How much do employers need to contribute to FSA to fix failure?**

A: The regulation does not really give a specific dollar amount, but we have run this question by outside legal counsel and the response we were provided with was to simply make sure that you contribute an amount that is useful.

The example that was given was that you could contribute an amount equal to your underlying health plan's office copay or prescription copay amount.

So, it doesn't have to be large amount, but something that is useful and that has some explanation behind why that dollar amount was given.

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We also feel that if you choose to make a contribution to avoid failing, you wouldn't want to do this only near the end of the plan year every year. Since employees cannot use these employer contributions for services incurred prior to the date the plan was amended, this could be looked at as an attempt to circumvent the rules in an effort to avoid tax consequences for highly compensated individuals.

**Q: Can you enroll 100% of eligible employees in a limited FSA if an HSA is in play?**

A: If your organization is considering making a Health Care FSA contribution for every employee, the employer can choose to make that contribution into a limited health FSA to avoid accidentally creating disqualifying coverage for employees if the limited health FSA is an option under the plan.

**Q: Would wellness incentives be considered compensation?**

A: Wellness incentives that are considered to be taxable to the employee would be considered to be part of the employee's gross compensation.

**Q: What about voluntary benefits?**

A: Whether a voluntary benefit is part of the cafeteria plan or not is dependent upon whether the employee pays pre-tax from the benefit or not.

If they do, then the voluntary benefit is part of the cafeteria plan and should be included in the testing data. If they do not, however, then it is not part of the cafeteria plan and should not be included in the data.

**Q: If all employees are eligible, is there a problem?**

A: If everyone is eligible for the Dependent Care FSA, then the Section 129 Eligibility Test will pass, but the other Section 129 tests may still fail because they are based on plan utilization and not on eligibility.

The same is true for the cafeteria plan. The Section 125 Eligibility Test will pass, but that does not guarantee that the other Section 125 tests will pass.

Self-funded health plans, however, are not guaranteed to pass the Eligibility Test even if all employees are eligible. Despite the name of the test, the Section 105 Eligibility Test really tests utilization of the plan and it can therefore fail regardless of whether all employees are eligible.

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**Q: I was at a conference last week and heard that they've only seen the DCAP fail nondiscrimination testing. Have you seen other benefits fail the test?**

A: We have seen all sorts of tests fail. One of the most common failures that we see is the Section 105 Eligibility Test for Health Care FSAs, the second most common failure is the Section 129 55% Average Test, and the third is the Section 125 Contributions and Benefits Test.

**Q: What are penalties if plan is audited and does not pass?**

A: If a plan does not pass, there are tax consequences that should be imposed upon the participating highly compensated employees in the affected plan. If this is not done, it is possible that the organization would have to go back and amend that individual's W-2 from the year that is impacted. It is also possible that the organization would have to amend the organization's quarterly payroll tax returns and the employer tax return to reflect that change. While we have not heard of any penalties tacked onto these tax adjustment, it is within the discretion of the auditor to consider the plan to be in operational failure in which case all tax breaks would be lost for all participants.

**Q: Is safe harbor profit sharing included in Compensation?**

A: If this profit sharing is taxable compensation or would be if it were not deferred into a tax-free account, then yes, it should be included in the individual's gross compensation.

**Q: What is the definition of FSA?**

A: An FSA is a flexible spending account. The Dependent Care FSA provides employees with the opportunity to set aside pre-tax funds to pay for expenses incurred for the care of their child(ren) or other eligible dependents, which allow the employee and spouse to work or look for work.

A Health Care FSA is a health plan benefit that provides employees with an opportunity to pay for certain eligible out-of-pocket medical, vision, and dental expenses on a pre-tax basis (governed by IRC 105 and 125).

A limited Health Care FSA is a self-funded health plan that provides employees with an opportunity to pay for certain dental and vision expenses on a pre-tax basis.

**Q: Who should we list as an officer for a municipality? We put the Village President.**

A: The Village President sounds like an appropriate title of an officer for a municipality, but it all has to do with what duties that individual holds within that particular municipality.

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**Q: For the officer, are we to put the annual compensation for 2019 or 2018? We haven't finished 2019 yet, so I am assuming 2018.**

A: The compensation period should be the same regardless of who the individual is. It looks back to the prior plan year unless that individual had no income within that plan year. If that individual had no income during the prior plan year, estimated current plan year compensation should be reported. Please see slide 18 for reference if your plan is a calendar plan and slides 20 and 21 if your plan is a non-calendar plan.

**Q: If we are reporting HSA contributions we should report the amount from 2018?**

A: No. The cafeteria plan premiums, HSA contributions, and FSA elections to use should be for the current plan year.

**Q: Would compensation include commissions, etc.?**

A: Presuming that the commissions are considered to be taxable income, they should be included in the gross compensation.

**Q: Would the POP safe harbor allow HSA or EAP (non-insured plans)?**

A: Yes, from our understanding, the only benefits that would cause a cafeteria plan to not satisfy the requirements of being a premium only plan is to offer FSAs.

**Q: Under §105, do I test each self-funded plan separately (so FSA separately from self-funded medical separately from self-funded dental)?**

A: Yes, every self-funded health plan needs to pass its own set of tests.

**Q: Must we include part time employees who are not eligible for any benefits?**

A: Yes, please reference slide 22 for a list of all employees who should and should not be included within the testing data.

**Q: Would deductions such as Medicare, Social Security, federal and state tax be needed to be added back into gross compensation for 2018?**

A: Yes, gross compensation is compensation prior to taxation and deductions.

**Q: If FSA was offered to more people, but not medical, would that help?**

A: The Affordable Care Act imposes a penalty on offering a Health Care FSA to individuals who are not also offered the employer-sponsored group medical plan. So, unfortunately offering the Health Care FSA to individuals who are not offered the medical plan is not an option.

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This restriction, however, is not imposed on the Dependent Care FSA. So, if an organization is having trouble passing the Section 125 Eligibility Test, choosing to offer the Dependent Care FSA to more employees may be a plausible solution.

**Q: Do we need to add back 457 plan? We do not have a 401k plan as we are a library.**

**A:** Yes, any employee pre-tax payroll deductions that are deferred into a 457 plan would need to be added back in when reporting gross compensation.

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