

Employee Benefits Corporation

Celebrating 30 Years

Fundamentals of Nondiscrimination Testing



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IRS Requirements
Common Data Errors
Reasons and How to Fix Failures
Outside Factors

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IRS Requirements

IRS Requirements

- **IRS Mandated testing for each plan year**
 - No exceptions
- **Test and results may be requested upon audit**
- **Test failure may result in taxation for highly compensated (HCE) and/or key employees**
- **Number of tests depends on plan type**
 - 2 tests per self-funded health plan
 - 4 tests per Dependent Care FSA
 - 3 tests per Cafeteria Plan

IRS Requirements

- Number of tests determined by plan type
- Each set of tests has own Highly-Compensated

Section 105 Self-funded Health Plan

- Eligibility*
- Benefits

Section 129 Dependent Care FSA

- Eligibility
- Contributions and Benefits
- 55% Average*
- 25% Concentration

Section 125 Cafeteria Plan

- Eligibility
- Contributions and Benefits*
- 25% Concentration*

IRS Requirements

- If 105 or 129 tests fail, 125 tests are impacted
- 125 tests must be done at end of plan year
- Premium Only Plan (POP) special rules
 - POP means no FSAs under the 125 plan
 - Pass Eligibility Test by Safe Harbor percentage, then only test required
 - > 20% of employees eligible for POP benefits



Common Data Errors

Common Data Errors

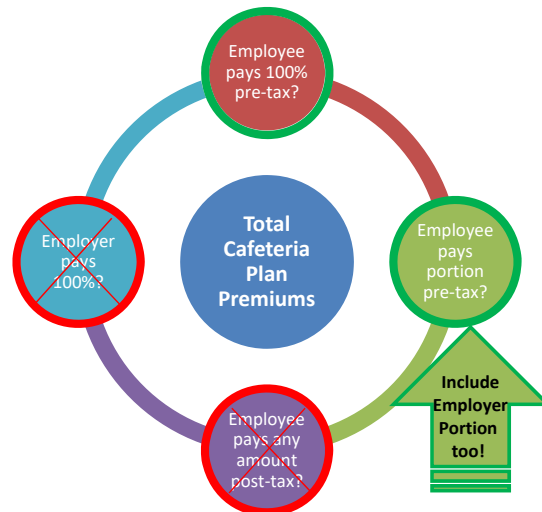
- **Incorrectly identifying cafeteria plan premiums**
 - ❌ – 100% employer-paid
 - ⊙ – 100% employee-paid pre-tax
 - ⊙ – Employer-paid portion if there is a pre-tax employee portion
 - **Example:**
 - Employer pays \$800 per month
 - Employee pays \$200 per month pre-tax
 - Include full \$1,000 when testing

Common Data Errors

- Incorrectly identifying cafeteria plan premiums

Use all pre-tax benefit plan premiums (health + dental + vision, etc.) for entire employee population

Include both employer AND employee-paid portions	Exclude any premiums paid post-tax such as COBRA or 100% employer-paid
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Common Data Errors

- Incorrectly identifying HSA contributions
 - ⊘ – Employer contributions if no option for employee to contribute pre-tax
 - ⊙ – Pre-tax employee contributions
 - ⊙ – Employer contributions if there is an option for employees to contribute pre-tax

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Common Data Errors

- **Officer not correctly identified**
 - All organizations have one per regulations
 - Based on duties and authority, not title
 - “Administrative Executive in regular and continued service”
 - A person who holds day-to-day authority over the operations of the organization during the prior plan year or gained this authority during the current plan year
 - Generally not Board Members or Trustees

Common Data Errors

- **Officer not correctly identified**
 - Examples:

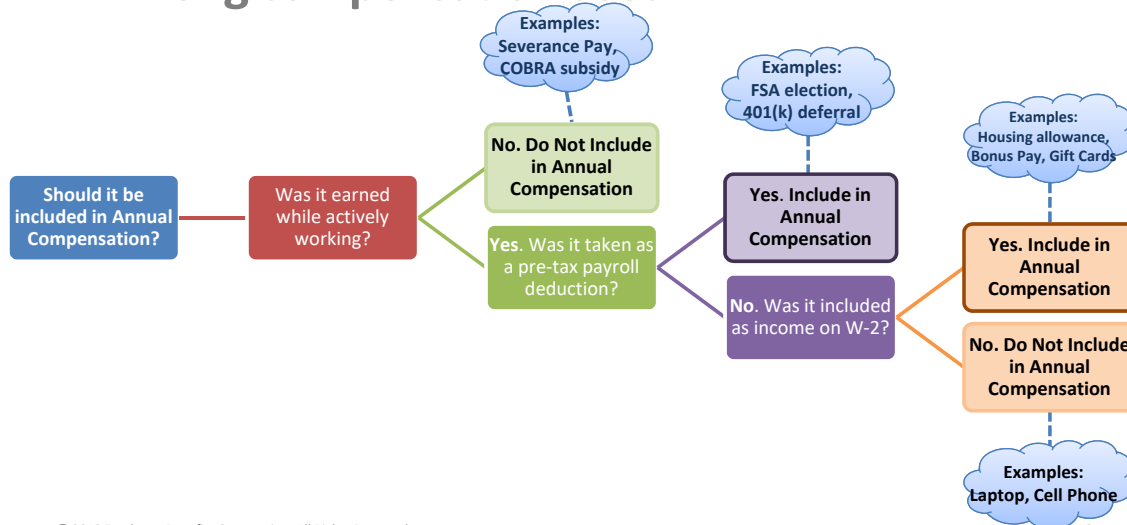
For-profit	Nonprofit	Others
<ul style="list-style-type: none"> • CEO • President • COO • possibly CFO 	<ul style="list-style-type: none"> • Executive Director • Managing Director 	<ul style="list-style-type: none"> • Retail Store Manager • School Superintendent • Municipal Administrator • City Administrator

Common Data Errors

- Wrong compensation used
 - Gross compensation includes
 - Any pay received from employment
 - Any non-monetary benefits that are taxable
 - Any income that was deferred into a tax-free account
 - Not Box 1 W-2 wages
 - Pre-tax deductions must be added back in

Common Data Errors

- Wrong compensation used



Common Data Errors

- Wrong compensation used
 - Compensation period looks back a year
 - Calendar plans use prior plan year
 - Short plan years should report as if the plan year was 12 months in duration and ended on same date

Common Data Errors

2019 Calendar Year Plan Example

Only include employees with any gross compensation in plan year being tested

Employee was hired before 1/1/2019
(start of plan year)

Employee was hired on or after
1/1/2019
(start of plan year)

Current Employee

Terminated
Employee

Current Employee

Terminated
Employee

1/1/2018 - 12/31/2018

1/1/2018 - 12/31/2018

Hire Date - 12/31/2019
(estimate through end
of year)

Hire Date -
Termination Date

Common Data Errors

- **Wrong compensation used**
 - Compensation period looks back a year
 - **Non-calendar plans have a choice**
 - Plan year reporting uses prior plan year
 - Calendar year reporting uses prior calendar year (calendar year that ended during plan year)
 - Short plan years should report as if the plan year was 12 months in duration and ended on same date

Common Data Errors

10/1/2018-9/30/2019 Plan Year using Plan Year Reporting Example

Only include employees with any gross compensation in plan year being tested

Employee was hired before 10/1/2018
(start of plan year)

Employee was hired on or after
10/1/2018
(start of plan year)

Current Employee

Terminated
Employee

Current Employee

Terminated
Employee

10/1/2017-9/30/2018

10/1/2017-9/30/2018

Hire Date - 9/30/2019
(estimate through end
of plan year)

Hire Date -
Termination Date

Common Data Errors

10/1/2018-9/30/2019 Plan Year using Calendar Year Reporting Example

Only include employees with any gross compensation in plan year being tested

Employee was hired before 1/1/2019
(start of calendar year)

Employee was hired on or after
1/1/2019
(start of calendar year)

Current
Employee

Terminated
Employee prior
to 1/1/2019

Terminated
Employee after
1/1/2019

Current
Employee

Terminated
Employee

1/1/2018 -
12/31/2018

1/1/2018 -
Termination Date

1/1/2018 -
12/31/2018

Hire Date -
12/31/2019
(estimate through
end of year)

Hire Date -
Termination Date

Common Data Errors

- **Extra employees or missing employees**
 - Employees employed during plan year
 - • Employees who terminated during plan year
 - • Employees hired during plan year
 - ⊘ • Employees who terminated prior to plan year beginning
 - – Employees of other controlled group entities
 - – Non-benefit eligible employees

Common Data Errors

- **Wrong eligibility used**
 - Refers to whether the employee was offered the benefit being tested
 - Should be considered eligible even if they gained or lost eligibility during plan year

Reasons and How to Fix Failures

Reasons and How to Fix Failures

- **Section 105: Self-funded health plans**
 - Excludable employees
 - **Ineligible employees who:**

Have not completed 3 years of service as of the first date of the plan year

Were under 25 as of the first date of the plan year

Customarily working less than 35 hours per week

Customarily work less than 9 months out of the year

Are part of a collectively bargained group who are not eligible

Are nonresident aliens with no US income

Reasons and How to Fix Failures

- **Section 105: Self-funded health plans**
 - Highly Compensated includes

Over 10% owners

Officers

Highest-paid 25% of non-excludable employees

- Eligibility Test*

- **Fails if more Highly Compensated individuals participate than non-Highly Compensated**

Reasons and How to Fix Failures

- Section 105: Self-funded health plans
 - Eligibility Test*
 - To avoid failure

Increase number of non-Highly Compensated participants

Decrease number of Highly Compensated participants

Limit eligibility

Auto-enroll all eligible employees by offering 100% employer-paid options (e.g. employer contributions to Health Care FSA)

Reasons and How to Fix Failures

- Section 105: Self-funded health plans
 - Benefits Test
 - Fails if Highly Compensated employees are offered
 - Shorter waiting period than non-Highly Compensated employees
 - Larger benefit pay-out than non-Highly Compensated employees

Reasons and How to Fix Failures

- **Section 105: Self-funded health plans**
 - Benefits Test
 - **Avoid failure by offering non-Highly Compensated employees**
 - Plan at the same time as Highly Compensated employees
 - Same benefits as Highly Compensated employees

Reasons and How to Fix Failures

- **Section 129: Dependent Care FSA**
 - Excludable employees
 - **Ineligible employees who:**

Are ineligible due to eligibility criteria stating an age requirement of age 21 (or older)

Are ineligible due to eligibility criteria stating a waiting period of one year (or more)

Are part of a collectively bargained group who are not eligible

Reasons and How to Fix Failures

- Section 129: Dependent Care FSA

- Highly Compensated includes

Over 5%
owners

Employees whose compensation
exceeds threshold

- Eligibility Test

- Fails if percentage of eligible non-HCEs is less than 20% of the percentage of eligible HCEs

Reasons and How to Fix Failures

- Section 129: Dependent Care FSA

- Eligibility Test

- Example

—% HCEs
eligible

2
eligible
HCEs



4 total
HCEs



50%
HCEs
eligible

—% non-
HCEs
eligible

50
eligible
non-HCEs



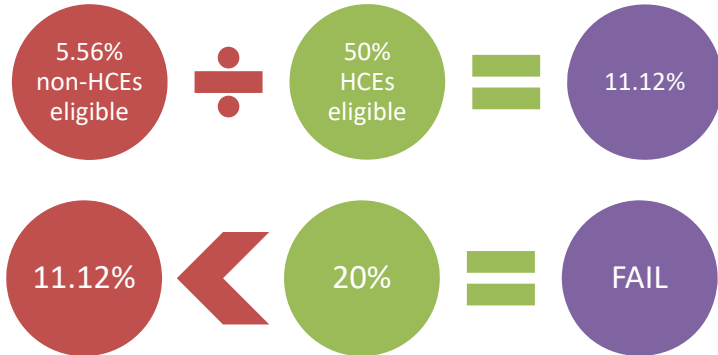
900 total
non-HCEs



5.56%
non-HCEs
eligible

Reasons and How to Fix Failures

- Section 129: Dependent Care FSA
 - Eligibility Test
 - Example



Reasons and How to Fix Failures

- Section 129: Dependent Care FSA
 - Eligibility Test
 - To avoid failure

Hire less seasonal or part-time employees

Expand eligibility for benefit

Reasons and How to Fix Failures

- **Section 129: Dependent Care FSA**
 - Contributions and Benefits Test
 - **Fails if Highly Compensated employees are offered**
 - Options that are not available to non-HCEs
 - » Onsite daycare
 - » Bussing programs
 - Larger benefit pay-out than non-HCEs

Reasons and How to Fix Failures

- **Section 129: Dependent Care FSA**
 - Contributions and Benefits Test
 - **Avoid failure by**
 - Same benefits as Highly Compensated employees
 - 55% Average Test*
 - **Fails if average non-HCE election is 55% or less of average HCE election (excluding non-HCEs earning less than \$25,000)**

Reasons and How to Fix Failures

- Section 129: Dependent Care FSA
 - 55% Average Test*

- Example

- Average HCE election

\$5,000
total HCE
election



20 total
HCEs



\$250 HCE
average

- Average non-HCE election

\$9,000 total
non-HCE
elections



1,000 total
non-HCEs
30 earn less
than \$25,000



\$9.28
non-HCE
average

Reasons and How to Fix Failures

- Section 129: Dependent Care FSA
 - 55% Average Test*

- Example

\$9.28
non-HCE
average



\$250
HCE
average



3.71%

3.71%



55%



FAIL

Reasons and How to Fix Failures

- Section 129: Dependent Care FSA
 - 55% Average Test*

- To avoid failure

Prohibiting HCEs from electing

Get taxed if they elect anyway

Can change elections to \$0

Limit HCEs elections

Constant monitoring required

- Mid-year election changes
- New hire elections

Cannot increase if results are better than anticipated

Reasons and How to Fix Failures

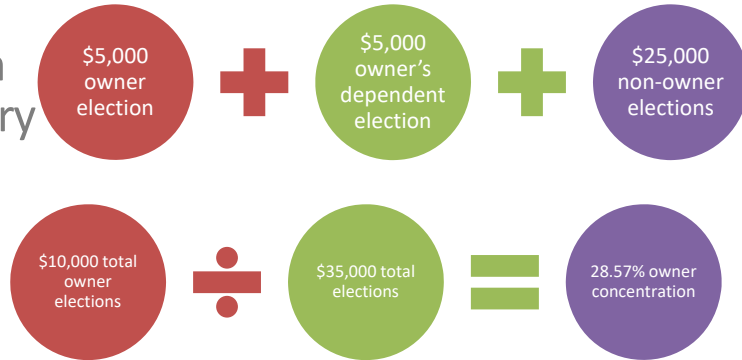
- Section 129: Dependent Care FSA
 - 25% Owner Concentration Test
 - Fails if more than 5% owners' and their spouses' and dependents' elections comprise more than 25% of the elections for the plan

Reasons and How to Fix Failures

- Section 129: Dependent Care FSA
 - 25% Owner Concentration Test

- Example

– Election
summary



Reasons and How to Fix Failures

- Section 129: Dependent Care FSA
 - 25% Owner Concentration Test

- Example



Reasons and How to Fix Failures

- **Section 129: Dependent Care FSA**
 - 25% Owner Concentration Test
 - **To avoid failure**

Prohibiting Owners from electing

Get taxed if they elect anyway

Can change elections to \$0

Limit owners elections to 33% of non-owners' elections

Constant monitoring required

- Mid-year election changes
- New hire elections

Cannot increase if results are better than anticipated

Reasons and How to Fix Failures

- **Section 125: Cafeteria Plan**
 - Excludable employees
 - **Ineligible employees who:**

Are part of a collectively bargained group who are not eligible

Reasons and How to Fix Failures

- Section 125: Cafeteria Plan
 - Highly Compensated includes

Over 5% owners

Employees whose compensation exceeds threshold

Officers

Spouse or tax dependents of any of these

Reasons and How to Fix Failures

- Section 125: Cafeteria Plan
 - Eligibility Test
 - Fails if percentage of eligible non-HCEs is less than 20% of the percentage of eligible HCEs
 - To avoid failure

Hire less seasonal or part-time employees

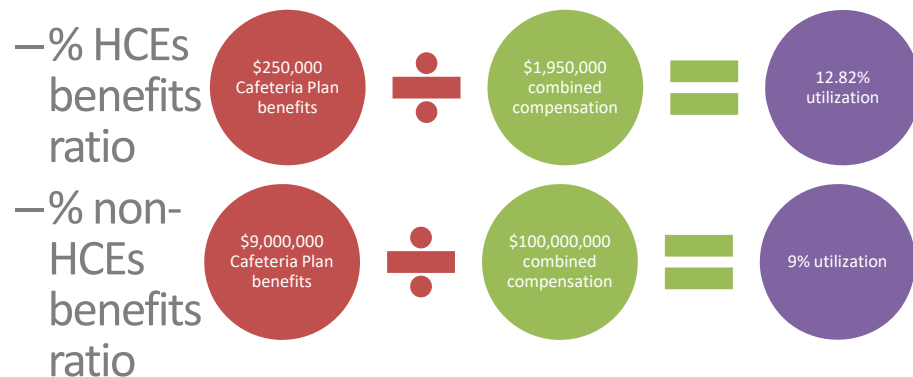
Expand eligibility for benefit

Reasons and How to Fix Failures

- Section 125: Cafeteria Plan
 - Contributions and Benefits Test*
 - Passes automatically if 75% or more of every medical plan premium for every eligible employee
 - Utilization Test
 - Fails if HCEs' benefit to compensation ratio exceeds non-HCEs'

Reasons and How to Fix Failures

- Section 125: Cafeteria Plan
 - Contributions and Benefits Test*
 - Utilization Test



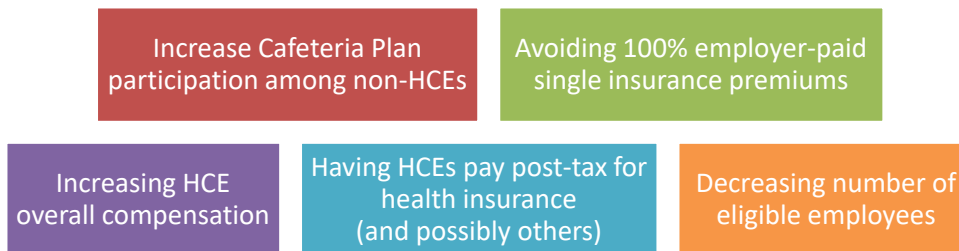
Reasons and How to Fix Failures

- Section 125: Cafeteria Plan
 - Contributions and Benefits Test*
 - Utilization Test



Reasons and How to Fix Failures

- Section 125: Cafeteria Plan
 - Contributions and Benefits Test*
 - Utilization Test
 - To avoid failure



Reasons and How to Fix Failures

- **Section 125: Cafeteria Plan**
 - Contributions and Benefits Test*
 - **Availability Test**
 - Fails if Highly Compensated employees are offered
 - » **Options that are not available to non-HCEs**
 - Better insurance plans
 - Additional insurance plans

Reasons and How to Fix Failures

- **Section 125: Cafeteria Plan**
 - Contributions and Benefits Test*
 - **Availability Test**
 - Avoid failure by
 - » **Offering same insurance plans to all eligible employees**

Reasons and How to Fix Failures

- Section 125: Cafeteria Plan
 - 25% Concentration Test
 - Key employees include

Officers who earn over key employee threshold

Over 5% owners

Over 1% owners who earn over \$150,000

Spouse or tax dependents of any of these

Reasons and How to Fix Failures

- Section 125: Cafeteria Plan
 - 25% Concentration Test
 - Example

– Election summary

\$25,000
10% owner election



\$25,000
owner's dependent election



\$190,000
non-key employee elections

\$50,000 total owner elections



\$240,000 total elections



26.32% key employee concentration

Reasons and How to Fix Failures

- Section 125: Cafeteria Plan
 - 25% Concentration Test
 - Example



Reasons and How to Fix Failures

- Section 125: Cafeteria Plan
 - 25% Concentration Test
 - To avoid failure

Prohibit key employees
from electing

Avoid 100% employer-paid single
insurance premiums

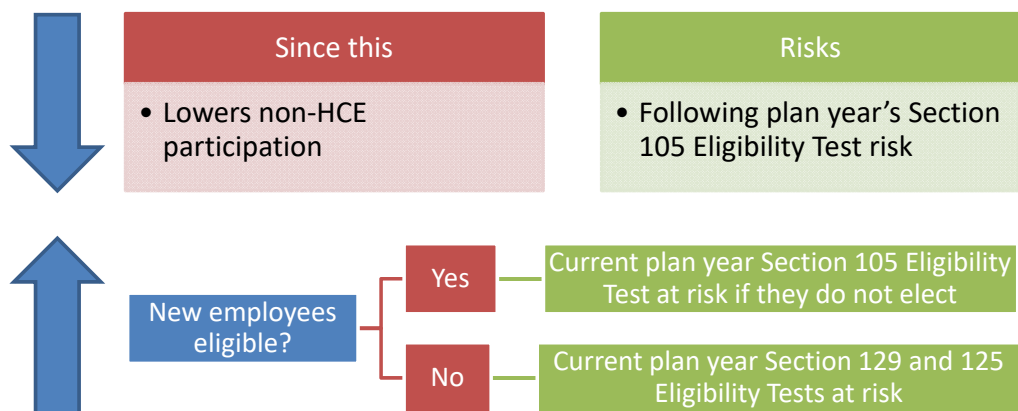
Have key employees pay
post-tax for insurance
(mostly health)

Wait to make HSA contributions
until end of plan year

Outside Factors

Outside Factors

- Large changes in number of total employees



Outside Factors

- Implementing a HDHP

Since

- Lower-paid individuals have a higher interest in HDHPs
- Implementing a HDHP alleviates most interest in Health Care FSA due to HSA interaction
- Limited Health Care FSA not as appealing

Risks

- Following plan year's Section 105 Eligibility Test risk

Outside Factors

- Changing plan year

Since

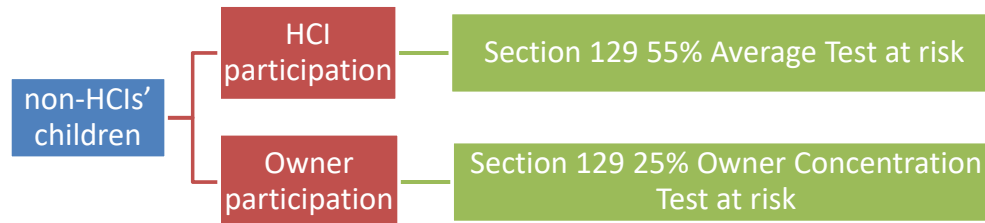
- FSA interest among non-HCEs declines due to increased risk of forfeiture

Risks

- Section 105 Eligibility Test risk
- Section 129 55% Average Test risk
- Section 129 25% Owner Concentration Test risk

Outside Factors

- Children aging out of Dependent Care



Questions?

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



Compliance Department
800 346 2126

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Thanks for Attending!!

Visit our online blog: <http://www.ebcflex.com/Education/ComplianceBuzz.aspx>

