From Premium Only to Premium Plus: Find the Cafeteria Plan That's Best for You - Webinar Q&A

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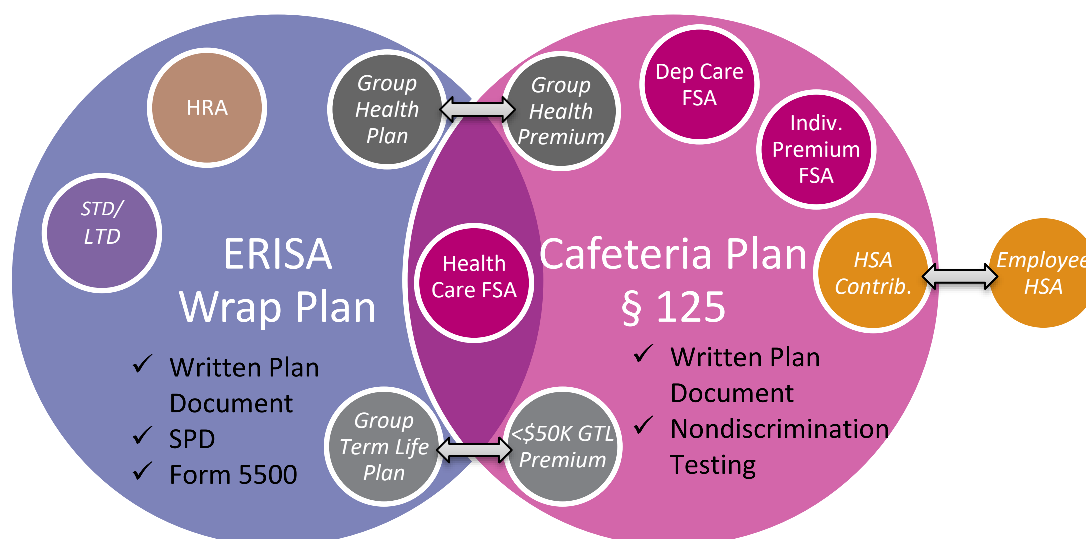
The following questions were asked during the two webinar sessions in June 2019:

Plan Documentation

Q: Is a wrap document a written cafeteria plan?

A: Not usually. Internal Revenue Code § 125 requires sponsors of a cafeteria plan to have a written plan document in order for the compensation and benefits included in the plan to receive favorable tax treatment. A "wrap plan" is typically the label given to a health and welfare benefit plan that covers more than one ERISA benefit. Wrap plan documents are prepared in order to meet the written document requirement under ERISA. Although both a cafeteria plan and an ERISA Wrap Plan have a written document requirement, they typically are not the same document because they have two different purposes and include different benefits. The picture below provides a visual illustration of the relationship between a cafeteria and an ERISA plan.



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Q: If you do not have a current Cafeteria Plan in place, can this be done mid-year?

A: If an employer is currently taking pre-tax payroll deductions to pay for insurance premiums without a cafeteria plan in place, they should either (1) immediately convert the payroll deductions to after-tax deductions or (2) adopt a cafeteria plan which allows for pre-tax deductions for the premiums. In either case, the employer should make payroll adjustments so that any pre-tax deductions withheld prior to plan adoption are adjusted to be after-tax.

You may wish to consult with outside legal or tax advisors to understand the implications of a mid-year plan set up, because generally the regulations do not permit retroactive implementation of a cafeteria plan.

Q: What are the requirements for sharing the cafeteria plan documents with employees/ participants? Does it suffice simply to have the written plan on file with the employer?

A: Code § 125 does not require the disclosure of any documents to plan participants. Therefore, if your plan does not include any ERISA benefits, then keeping the written cafeteria plan on file meets the requirements of the code. Your participants, however, may find a summary of the cafeteria plan to be helpful.

If your cafeteria plan contains an ERISA benefit, such as a Health Care FSA, then you are required to distribute a Summary Plan Description (SPD), as well as a Summary of Material Modifications (SMM) if and when an ERISA plan is amended. Any of your cafeteria plan's component benefits that are subject to ERISA would require separate plan documents that comply with ERISA as well, and SPD and SMM distribution would be required.

SPDs must be distributed to plan participants within 120 days when the plan is new and within 90 days for new participants. You must also redistribute the SPD every 10 years if there are no changes or every 5 years if you have provided updates by SMM for material changes. If you wish to provide SPDs electronically, you must meet Department of Labor requirements for electronic distribution.

Employee Benefits Corporation provides an SPD (together with the My Company Plan) that employers may distribute to participants for all of our BESTflex Plans, including Premium Only Plans. We find these materials are helpful for employers and employees alike for questions that participants may have regarding their plan.

Q: Does Employee Benefits Corporation offer a form for opt out of the pretax benefits?

A: Yes, Employee Benefits Corporation does have a form available upon request which allows employees to opt-out of pre-tax benefits, however no special form is needed. You can accept any form of notice from your employees to opt-out of pretax benefits, as long as you have indicated you will accept it in your plan document.

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Q: Is Employee Benefits Corporation's "My Company Plan" considered our cafeteria plan document?

A: Employee Benefits Corporation provides a BESTflex Plan Document that is to be kept with the BESTflex Plan Adoption Agreement and together they comprise the legal plan document. The My Company Plan is an appendix to the cafeteria plan SPD, and those documents are provided both for convenience and to meet ERISA requirements for the Health Care FSA, if the plan includes one. Every client has access to the "Plan Document" and the "Summary Plan Description" (SPD) as well as the "My Company Plan" (MCP) for the cafeteria plan through the employer portal. The employer should make sure the employee has the SPD and the MCP to communicate the details of the plan.

Insurance Premiums/Component Plans

Q: Are there any circumstances in which an employee would not want to participate in a POP plan?

A: There are a few disadvantages of participating in a cafeteria plan that employees should consider, the most common being:

1. Elections made under a cafeteria plan are irrevocable. If a participant knows they will want to make any mid-year changes to their elections (without having a permitted election change event), they may be better paying for the benefits post-tax so that they can make mid-year reductions to their salary withholdings.
2. Salary reductions may result in lower Social Security benefits. Social Security benefits are calculated by averaging an individual's 35 best income-earning years. Salary reductions may reduce an employee's covered earnings – which could have an impact on the benefits later in life under Social Security.
3. Specific to Dependent Care FSAs, participating in a Dependent Care FSA would then not allow you to file the same expenses under the Dependent Care Tax Credit (DCTC) under Code § 21.

Q: If you pre-tax deduct the life and disability insurance premiums, will the benefit will be taxed?

A: For life insurance plans: Group term life insurance on the life of the employee is excludable from gross income up to a benefit of $50,000. The life insurance proceeds payable upon death to a beneficiary are not includable in income for federal tax purposes, regardless if paid for with pre-tax or post-tax dollars.

For disability plans: In general, if the benefit is not taxed on the premium side, it will be when a disability claim is paid. Vice versa, if premium is taxed, the benefit will not be taxed. If the premium is paid with a combination of pre-tax and after tax dollars, the benefits are taxable on a pro rata basis.

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Q: If the employer pays for any of the ineligible premiums, must the employer charge imputed income?

A: This depends on the specific premium that the employer is paying for. Some benefits should be charged to the employees as imputed income, others not.

- Spouse or dependent group term life: Dependent life insurance does not qualify for tax advantages. Any employer-provided premium will be treated as gross income of the employee (unless it can be regarded as *de minimis*).
- Employee group term life exceeding $50,000 in coverage: Premium for coverage in excess of $50,000 is includable in the gross income of the employee.
- Individual medical insurance: Per ACA, employers are not permitted to pay for individual medical insurance of their employees on either a pre- or post-tax basis.
- Long term care: Please see question below.
- Whole, universal, variable life coverage or coverage with return of premium feature: These coverage types are not eligible be paid for with pre-tax dollars and tax adjustments should be made

Whenever there has been an error in the tax treatment of a benefit you should seek the advice of a tax advisor.

Q: If the employer pays for a long-term care plan in full, should that have imputed income added?

A: If an employer is offering a qualified long-term care insurance contract, it is treated similarly to accident or health coverage and as a result, premiums paid by the employer are generally excludable from the employees' income.

If the employer is offering the qualified long-term care insurance contract through a flexible spending or other arrangement, the federal income tax exclusion is lost.

Even though an individual might be able to claim a portion of the long term care premiums as medical expenses on their federal income tax return, the IRS does not recognize long-term care insurance premiums as a qualified benefit under the cafeteria plan rules.

Q: Is a VEBA considered a component benefit plan within a POP plan?

A: A voluntary employees' beneficiary association (VEBA) is generally not a qualified benefit under the cafeteria plan rules. In general, welfare benefit plans (such as medical, dental, LTD, and more) are provided through a VEBA. In this case, the component benefit plans would be what would be listed within the POP plan. VEBAs have separate plan document requirements.

If an employer offers benefits through a VEBA, it is important to keep in mind that if the IRS would ever conduct a cafeteria plan audit, they would require copies of Form 990s. There would be additional information necessary for nondiscrimination testing when plans are funded through a VEBA as well.

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Elections and Election Changes

Q: Does the election choice need to be made every annual open enrollment or can a previous year's election can be applied to future years?

A: In order to answer this question, we will look at different types of elections, including (1) insurance coverage elections, (2) pre-tax vs. after-tax payment of premiums, and (3) FSA elections. Regardless of the decision the employer makes regarding elections, remember that an employee must have an option to opt-in or opt-out of participation in the cafeteria plan, and all cafeteria plan election choices should be described in the cafeteria plan document.

1. Insurance coverage choices are not elections made through a cafeteria plan, but on a coverage level. Employers may require new elections annually for coverage choices, or the employer may provide that current elections will continue unless an employee submits a change request. Whichever model an employer chooses, it should clearly communicate its enrollment options each year so the expectation is made clear to participants.
2. For the pre-tax status of premium withholdings for that coverage, this is often set up as automatic enrollment and then auto-renewed under "evergreen" elections each year. Automatic enrollment means that depending on the coverage choice an employee makes (see #1 above), the employee agrees that they are opting to pay for premiums for that coverage on a pre-tax basis automatically. With an evergreen election, employees should be advised when first enrolling that their elections will automatically be pre-tax unless (or until) the employee requests otherwise if they enroll in a particular qualified benefit like insurance coverage. An employer does not have to use automatic or evergreen elections – they could ask their employees to elect the pre-tax vs. after-tax payment both upon reaching eligibility and again each year with other open enrollment elections.
3. For FSAs, most commonly employees are asked to make elections annually as the elections are irrevocable and situations change year to year. However, if an employer is clear in its plan documents and communication, it is permissible to have FSA elections be automatic and/or evergreen. Employers generally only do so, however, when the employer is making a certain FSA contribution amount available to everyone.

Under the BESTflex Plan offered by Employee Benefits Corporation, employees must elect flexible spending account options they wish to contribute to each year. For purposes of insurance premiums under the BESTflex Plan or BESTflex Premium Only plan, anyone who is enrolled in the qualified benefits under the plan is automatically participating in the pre-tax benefit unless the employee requests otherwise. Evergreen elections only apply to the premiums; employees' pre-tax status will carryover one cafeteria plan year to the next unless the employee drops underlying coverage or expresses that they want premiums to be withheld after-tax at open enrollment for the next plan year. This typically will streamline the enrollment process for the employer.

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Q: Is it okay to change POP language to allow employees to drop coverage and pre-tax premiums mid-plan year? If mid-year changes are detailed in the plan document, is it okay?

A: Yes and no. Yes, it is ok and is in fact a requirement to include the reasons employees are allowed to make election changes to their cafeteria plan elections mid-year, **however**, the reasons you can include are limited to a prescribed list of qualifying events determined by the IRS. Employers can choose to include only some of the allowable permitted election change events, but they are not permitted to add additional change events, even if they are added to the document. In addition to the list of allowable events, the change being made by a participant typically must be *consistent* with the event in order to be permitted.

"Consistent with" example: Your spouse loses their job and their benefit eligibility. This would allow you to add or increase your pre-tax elections. This would not permit you to drop or decrease your pre-tax elections.

Employee Benefits Corporation includes all of the IRS-approved change of status events in our BESTflex and BESTflex Premium Only plans.

HSA Contributions

Q: What is the reason the employer would make their HSA deposits through the cafeteria plan? Would it be to make them tax-free to the employee? Are employer HSA contributions outside of the Cafeteria Plan is taxable to the employee?

A: There are multiple reasons that an employer would want to make their HSA contributions through the cafeteria plan. The primary reason is to allow employees to contribute to their own HSAs through pre-tax salary reduction through the cafeteria plan, because once that is allowed, then all employer contributions are deemed to have been made through a cafeteria plan as well. The other major reason is to avoid the comparability rule (which imposes an excise tax of 35% if contributions are not comparable).

If an employer does not allow HSA contributions (either employee or employer funds) through the cafeteria plan, employer contributions to the HSA are still usually non-taxable under IRC § 106 as long as the employer reasonably believes that the employee will be able to exclude the contribution from their income. At its most basic, the employer would need to know that the employee has qualifying HDHP coverage and is not covered by disqualifying other coverage provided by the employer. However, the employer will also need to complete and document the results of comparability testing each calendar year to prove that the contributions outside of a cafeteria plan are made equally for all employees within a certain class.

Note that if employer contributions are made to partners of a partnership or more-than-2% shareholders of an S corporation, the employer cannot get tax breaks for its contribution; the accountholder is both ineligible to participate in a cafeteria plan and IRC § 106 does not apply (though comparability rules still do). In that case employer contributions must be made on an after-tax basis, and the accountholder can only take a tax deduction at the end of the year.

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Q: Can an employer split employer HSA contributions inside and outside of the cafeteria plan to satisfy testing?

A: No. If an employee is permitted to make pre-tax HSA contributions through a cafeteria plan, then any employer contributions to eligible employees must be made through the cafeteria plan. Likewise, if the employee is not allowed to make pre-tax HSA contributions (all of the employee contributions are taxed), then all employer contributions would be outside of the cafeteria plan.

Remember that certain individuals are not eligible to participate in cafeteria plans (please refer to slide 14). Any contributions made on behalf of ineligible participants from either the employee/owner themselves or from the company must be contributed after-tax as they cannot be made pre-tax through the cafeteria plan.

Other Questions

Q: For nondiscrimination purposes, is it okay for employers to contribute a larger percentage to one health plan option than to another? For example, employer contributes 70% to the HDHP but only 30% to the PPO plan in order to incentivize HDHP participation.

A: Yes, but proceed with caution.

This will be impacted by the funding for the plan. Prior to ACA, if the plan is fully-insured, employers were not required to complete nondiscrimination testing. ACA included a requirement for nondiscrimination rules for all health plans effective 1/1/2011 (including insured plans) however, it is not being enforced until guidance is issued. Currently 8 years later, there is no sign of guidance on this matter, so employers with insured plans can treat employees differently as long as the arrangement meets state insurance laws.

For self-insured plans, nondiscrimination testing is required and you may want to review with your legal counsel on how this will be tested.

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