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Patient Protection and Affordable Care Act Establishes Simple Cafeteria Plans

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The Patient Protection and Affordable Care Act (H.R. 3590) as signed into law by President Obama on March 23, 2010, creates a “simple cafeteria plan” for small businesses. Under such a plan an eligible small business is provided with a *safe harbor* from the nondiscrimination requirements for cafeteria plans as well as from the nondiscrimination requirements for specified qualified benefits offered under a cafeteria plan, including group term life insurance, benefits under a self-insured medical expense reimbursement plan, and benefits under a dependent care assistance program.

If small businesses satisfy the eligibility requirements for simple cafeteria plans, they may now provide competitive cafeteria plans without the costly administrative and burdensome discrimination requirements previously associated with these plans. However, whether these simple cafeteria plans will catch-on with small employers is yet to be seen as the rules continue to prohibit owner participation.

Under a typical cafeteria plan, an employer may offer a menu of nontaxable benefits and cash from which participating employees may select. The value of the nontaxable qualified benefits that a participant elects to receive is not includible in income. However, IRC §125 requires that such plans not discriminate in favor of highly compensated participants or key employees, or benefits received by such individuals are includible in income.

The new law, generally effective for years beginning in and after 2011, provides that a “simple cafeteria plan” is a cafeteria plan that: (i) is established and maintained by an eligible employer; (ii) meets prescribed contribution requirements; and (iii) meets prescribed eligibility and participation requirements. If these requirements are satisfied, the small business may avoid (as a *safe harbor*) the nondiscrimination requirements for cafeteria plans as well as the nondiscrimination requirements for specified qualified benefits offered under a cafeteria plan, including group term life insurance, benefits under a self-insured medical expense reimbursement plan, and benefits under a dependent care assistance program.

Eligible Employer

An eligible employer is, with respect to any year, any employer that employed an average of 100 or fewer employees on business days during either of the two preceding years. For these purposes, a year may only be taken into account if the employer was in existence throughout the year. If an employer was not in existence throughout the preceding year, the determination will be based on the average number of employees that it is reasonably expected the employer will employ on business days in the current year.

If an employer was an eligible employer for any year and the employer established a simple cafeteria plan for its employees

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for that year, then, notwithstanding the fact the employer fails to meet the eligible employer requirements for any later year, the employer will be treated as an eligible employer for that later year with respect to employees which were covered by the plan during any qualified year. However, this provision will cease to apply if the employer employs an average of 200 or more employees on business days during any year preceding any such later year.

Contribution Requirements

The employer must make a contribution to provide qualified benefits under the plan on behalf of each qualified employee (without regard to whether a qualified employee makes any salary reduction contribution) in an amount equal to: (i) a uniform percentage (not less than 2%) of the employee's compensation for the plan year; or (ii) an amount which is not less than 6% of the employee's compensation for the plan year or twice the amount of the salary reduction contributions of each qualified employee (whichever amount is less). "Compensation" generally has the meaning proscribed in IRC §414(s). A qualified employee means any employee who is not a "highly compensated employee" or a "key employee" and who is eligible to participate in the plan.

Eligibility and Participation Requirements

The minimum eligibility and participation requirements to be a simple cafeteria plan are met with respect to any year if, under the plan: (i) all employees who had at least 1,000 hours of service for the preceding plan year are eligible to participate; and (ii) each employee eligible to participate in the plan may, subject to terms and conditions applicable to all participants, elect any benefit available under the plan. However, an employer may elect to exclude those employees who have not attained the age of 21 be-

fore the close of a plan year, those employees who have less than one year of service, those employees who are covered under a collective bargaining agreement, or those employees who are nonresident aliens.

The simple cafeteria plan provides an incentive for small business owners to sponsor cafeteria plans, thereby making it easier for the employees of these businesses to be covered by health insurance and other valuable employee benefits just as it is for their counterparts who work for larger businesses. By meeting the eligibility requirements, small businesses may now provide competitive cafeteria plans without the costly administrative and burdensome discrimination requirements previously associated with these plans. Whether these simple cafeteria plans will catch-on with small employers is yet to be seen as the rules continue to prohibit owner participation.

Small businesses that would like to adopt a simple cafeteria plan for their qualified employees should contact us to prepare a plan document that satisfies the requirements of the new law.

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