

WEBINAR TAKEAWAYS: NONDISCRIMINATION TESTING



Nondiscrimination Testing applies to plans that provide pre-tax benefits to their beneficiaries and is designed to prevent plans from discriminating in favor of highly compensated individuals (HCIs ie. executives) vs. rank-and-file employees.

Cafeteria Plan = Subject to Section 125

Definitions:

Highly Compensated Individual (HCI):

- » Officer
- » 5% Shareholder
- » Compensation of previous plan year meets definition of HCI for purposes of 401(k) plan + if elected by employer, is in top-paid group (of top 20%) of employees when ranked on basis of compensation paid during that year **OR**
- » Spouse or dependent of person described above

Key Employee

- » Officer of employer w/ annual compensation > dollar amount specified in the definition of "Key Employee" under rules for 401(k) plans
- » 5% owners of the employer **OR**
- » 1% owner of the employer w/ annual compensation from the employer > \$150,000

3 tests required as of the last day of each plan year:

1. Eligibility Test

- » **Employment Requirement:** The same new hire period must apply to all employees & can't be longer than 3 years.
- » **Entry Requirement:** Employees must be eligible immediately following the waiting period.
- » **Nondiscrimination Requirement:** The plan benefits employees who qualify under a reasonable classification established by the employer, and the classification of employees is nondiscriminatory.

2. Contributions & Benefits Test:

- » **Availability Standard:** Similarly situated employees must be given the same opportunity to elect benefits.
- » **Utilization Standard:** Tax-free benefits available to HCIs must compare favorably with the tax-free benefits of non-HCIs.
- » **Nondiscrimination Standard:** The plan must ensure it does not discriminate in practice.

3. Key Employee Concentration Test

- » Do key employees receive too large a share of total benefits under the plan?
- » Key employee benefits can't be more than 25% better than all employees' benefits under the plan.

Test Failure =

- » All HCIs and Keys taxed on amount of their pretax contributions
- » All amounts subject to tax must be reported on the HCIs' Form W-2 for purposes of income tax, FICA, and FUTA

Health FSA = Subject to Section 105

Definition:

Highly Compensated Individual (HCI):

- » One of 5 highest paid officers
- » > 5% Shareholder **OR**
- » Among the highest paid 25% of all employees

2 tests required throughout the year:

1. Eligibility Test

- » **70% Test:** The plan must benefit 70% or more of all employees.
- » **70% / 80% Test:** The plan must benefit 80% or more of all employees eligible to benefit under the plan if 70% or more of all employees are eligible to benefit under the plan.
- » **Classification Test:** The plan must benefit those employees that qualify under a classification of employees set up by the employer which is found by the IRS not to be discriminatory in favor of HCIs.

2. Benefits Test

» Discrimination on the Face

- » Benefits provided for HCIs must be provided to all other participants (type, amount reimbursed).
- » Amount of reimbursement may not be in proportion to compensation, age, or years of service.
- » Required employee contributions must be the same for all benefit levels.
- » Different waiting periods may not be imposed.

» Discrimination in Operation

- » Determination is made on the basis of the facts & circumstances of each case.
- » A plan is not considered discriminatory merely because HCIs in the plan utilize a broad range of plan benefits to a greater extent than other plan participants.
- » If a plan or benefit is amended or terminated and the duration of the plan or benefit coincides with the period during which an HCI utilizes the benefit, the plan would be discriminatory.

Test Failure =

- » Eligibility Test failure: Each HCI is taxed on the amount of benefits paid to the HCI under the FSA multiplied by the ratio:
FSA \$ paid to HCI x (All benefits paid to all HCIs / Benefits paid to all participants) = Tax Amount
- » Benefits Test failure: HCIs are taxed on total benefits received under the FSA.
- » All amounts subject to tax must be reported on the HCIs' Form W-2 for purposes of income tax but not for FICA or FUTA.

Have questions? Contact admin@compliancedashboard.net.