

NONDISCRIMINATION TESTING



LISI

REQUIREMENTS FOR TODAY'S CE

- Today's CE Course has been approved for one (1) Continuing Education Credit (Life & Health) in the following state(s):
 - [CALIFORNIA]
- During the Instructional Period, you may not conduct other business or read materials unrelated to the course. There will be 4 questions that you must answer.
- All electronic devices must be silenced.
- Each State requires attendance for 100% of the approved class hours. If you arrive after the class has begun, or if you are late returning from breaks, you may be denied credit for the course.
- Upon successful completion of the course, you will be issued a Course Completion Document (Certificate) showing the course approval number, eligible license classes and the number of credits you have received for completing the class.
- Lastly, take notes and ENJOY!!

TOPICS FOR TODAY

1

Non-Discrimination
Testing (NDT)
Overview

2

Review of the
Relevant NDT Tests

3

Recommendations
for Successful
Results

4

Important
Strategies to
Ensure Success



WHY IS NDT IMPORTANT?

#1: IT IS REQUIRED!!

#2: Ensures equality

- Highly compensated employees pre-tax benefits are proportionate to the Non-highly compensated employees benefits.
- Eligibility, Contributions and Benefits are available to all employees on a nondiscriminatory basis.



WHY IS NDT IMPORTANT?

#3: High Stakes

- Results subject to IRS audit; Solid documentation is key
- If a plan is disqualified, it loses its tax-advantage status
- Failures of Testing can result in tax penalties.



WHAT IS NDT?

Cafeteria Plans
Health FSA'S



DCAP'S
HRA'S

TAX SAVINGS!

The tax advantages for certain "highly compensated employees" are conditioned upon these plans meeting certain nondiscrimination requirements.

HIGHLY-COMPENSATED & KEY EMPLOYEES

Defining & Identifying

WHAT IS NDT?

"TARGETED GROUP"

- General term referring to the highly compensated employee, highly compensated participant and key employee group;
- Definition of HCE change
 - Section 125
 - Section 105(h)
 - Section 129



PLANS CAN'T DISCRIMINATE IN FAVOR OF CERTAIN HIGHLY COMPENSATED AND KEY EMPLOYEES

- Reason for favorable tax treatment is to encourage employers to give benefits to rank-and-file employees
- NDT rule designed to prevent employers from solely providing tax benefits to executives
- Rank-and-file get their share of tax benefits



IDENTIFYING HIGHLY COMPENSATED AND KEYS

- The individuals considered HCEs or Keys vary from one plan to the next
 - DCAP NDT rules look at an individual's compensation during the preceding year to determine HCE status based on compensation
 - Health FSA nondiscrimination rules look to an individual's compensation during the current year to determine status as an HCE based on compensation
- Section 105
 - One of the five highest-paid officers (current plan year);
 - a shareholder who owns more than 10% of the value of the employer's stock (attribution applies); or
 - among the highest-paid 25% of all employees (other than excludable employees who are not participants)



NDT THEMES

- **Eligibility.** If enough non-HCEs cannot get into a plan, then it will be discriminatory.
- **Benefits.** A plan will not pass NDT if the HCEs/Keys are able to get more benefits than the non-HCEs. This is sometimes called a “contributions and benefits test.”
- **Utilization.** A plan will not pass NDT if the HCEs/Keys actually take more benefits under the plan. This is sometimes called a “utilization test” or “concentration test.” It is often the most difficult to pass, especially for smaller employers.



CONTROLLED AND AFFILIATED SERVICE GROUPS

- For plan testing purposes, the Code treats two or more employers as a single employer if there is enough common ownership and control among and between entities
 - Rules are described in Code §§414(b), (c), and (m)
 - Rules are complex and determining common control is responsibility of plan sponsor and should be performed by their legal counsel or accountant



COMMONLY CONTROLLED GROUPS

- Parent-Subsidiary Controlled Group of Corporations
 - A parent-subsubsidiary controlled group is one or more chains of corporations connected through stock ownership with a common parent if
 - 80% or more of the total combined voting power of all classes of stock entitled to vote (or 80% or more of the total value of all shares of all classes of stock) of each of the corporations, except the common parent, is owned directly or indirectly by one or more of the other corporations; and
 - The common parent corporation owns, directly or indirectly, 80% or more of the total combined voting power of all classes of stock entitled to vote (or 80% or more of the total value of shares of all classes of stock) of at least one of the other corporations



WHEN NDT SHOULD BE PERFORMED

- 2007 Proposed Regulations, Code §125 nondiscrimination tests are to be performed as of the last day of the plan year
- Best practice is to perform at least one test mid plan year to determine whether corrective actions or additional steps should be taken before the end of the plan year in order to ensure plan passes as of last day of the plan year
- Subsequent and final test would then be performed as of the last day of the plan year



LISTING OF RELEVANT NDT BY BENEFIT

Benefit Type	Eligibility	Benefits	Contribution & Benefits	Key Employee Concentration	More than 5% Owners Concentration	55% Average Benefits	N/A
Cafeteria Plans / POP	✓		✓	✓			
Health FSA	✓	✓					
Dependent Care	✓		✓		✓	✓	
Group Term Life	✓	✓					
Self-Insured Plans	✓	✓					
Fully-Insured Plans							✓
Adoption Assistance	✓				✓		

WHAT IS NDT?

CAFETERIA PLAN TESTING

- 1) **Eligibility Test:** Three part test to ensure that enough non-highly compensated employees (non-HCEs) are eligible to benefit from the cafeteria plan.
- 2) **Contributions & Benefits Test:** Contributions and benefits are available on a nondiscriminatory basis and that HCEs do not select more nontaxable benefits than do non-HCEs.
- 3) **Key Employee Concentration Test:** Key Employees do not receive more than 25% of the aggregate benefits offered through the cafeteria plan

CAFETERIA PLAN NONDISCRIMINATION TESTING

Eligibility Test (First of Three)

- A two-part Nondiscriminatory Classification Test is applied, requiring (1) a bona fide business classification for those included or excluded from the plan; and (2) a sufficient ratio of eligible non-HCIs to eligible HCIs (a numeric test)
- Safe Harbor for Premium Only Plans (POPs)
 - If a POP passes the Eligibility Test (i.e., entry requirement, reasonable classification and the safe harbor percentage) then the POP automatically passes the Contribution and Benefits Test as well as the Key Employee Test



CAFETERIA PLAN NONDISCRIMINATION^{1B} TESTING

Eligibility Test: Prohibited Group (Who's Highly Compensated?)

Highly Compensated Participant under Code §125(e)(1):

- An Officer
 - determined based on all facts and circumstances, including source of person's authority, the term for which he or she is elected or appointed, and the nature and extent of the officer's duties
- More-than-5% shareholder
 - someone owning more than 5% of the voting power or value of all classes of stock of the employer determined without attribution
- Highly compensated
 - individual who, for the preceding plan year (current plan year in the case of first year of employment) had compensation in excess of Code §414(q)(1)(B) (\$120K in 2016 & 2017)
- A Spouse or Dependent (§125(e)(1)(D)) of someone listed above



1.1B - The Eligibility Test

(PERCENTAGES)

- Nondiscriminatory if the plan's ratio percentage is 50% or more

	<i>Total NHCI</i>	6	
Non-highly Compensated Individual (NHCI) Concentration Percentage			
=	<i>Total employees</i>	22	= 27.27%
Safe Harbor Percentage =	<i>(According to Table)</i>	50.00%	
Unsafe Harbor Percentage =	<i>(According to Table)</i>	40.00%	
	<i>Eligible HCIs</i>	16	
Highly Compensated Individual (HCI) Benefiting Percentage =			= 100.00%
	<i>Total HCIs</i>	16	Percentage #1
	<i>Eligible NHCI's</i>	2	
Non-highly Compensated Individual (NHCI) Benefiting Percentage =			= 33.33%
	<i>Total NHCI's</i>	6	Percentage #2
	<i>Benefiting NHCI's %</i>	33.33%	
Plan's Ratio Percentage =			= 33.33%
	<i>Benefiting HCIs %</i>	100.00%	

Test Result: FAIL

1. Eligible HCE's (divided by) Total HCE's = Percentage #1
2. Eligible non-HCEs (divided by) Total non-HCEs = Percentage #2
3. Take Percentage #2 (divided by) Percentage #1 = Plan's Ratio Percentage (**this must be at least 50%**)

CAFETERIA PLAN NONDISCRIMINATION TESTING

Contribution and Benefits Test (Second of Three)

“Are contributions and benefits available on a nondiscriminatory basis and do highly compensated participants (HCPs) elect more nontaxable benefits than non-HCPs do?”



1.2 - Contributions & Benefits Test

(PERCENTAGES)

- This test is designed to make sure that contributions and benefits are available on a nondiscriminatory basis and that HCEs do not select more nontaxable benefits

HCP qualified benefits and compensation ratio =	$\frac{\text{Aggregate HCP qualified benefits}}{\text{Aggregate compensation of HCP group}}$	$\frac{\$21,750.96}{\$367,368.09}$	= 5.92%
			Percentage #1
NHCP qualified benefits and compensation ratio =	$\frac{\text{Aggregate NHCP qualified benefits}}{\text{Aggregate compensation of NHCP group}}$	$\frac{\$5,798.08}{\$330,306.21}$	= 1.76%
			Percentage #2
Is (HCP qualified benefits and compensation ratio) less than (NHCP qualified benefits and compensation ratio)?	Fail	Is 5.92% less than 1.76%?	

CAFETERIA PLAN NONDISCRIMINATION TESTING

Key Employee Concentration Test (Third of Three)

“Do qualified benefits provided to key employees exceed 25 percent of those same benefits provided for all employees under the plan?”



CAFETERIA PLAN NONDISCRIMINATION TESTING

Key Employee Concentration Test

Prohibited Group (Who's Key?)

- Key Employee under Code §416(i)(1):
 - officers with annual compensation (prior plan year) greater than a specified dollar threshold (\$175,000 for 2017 and \$175,000 for 2018)
 - more-than-5% owners
 - more-than-1% owners with compensation over \$150,000 (not indexed)

*The number of officers for Code §416 purposes is limited to no more than 50 employees (or, if less, the greater of three employees or 10% of the employees)

**Sole proprietorships, partnerships, and associations, along with other unincorporated entities, may have officers

*** Code §318 attribution rules apply for purposes of both corporate and noncorporate entities, with slight modification



1.3 Key EE Concentration

(PERCENTAGES)

- Tests to ensure that HCEs do not receive more than 25% of the aggregate benefits offered through the cafeteria plan
- Determines the total value of nontaxable benefits provided under the cafeteria plan and tests whether HCEs receive more than 25%

Aggregate benefits of key employees =	(According to input data)	\$12,240.96	
Aggregate benefits of all employees =	(According to input data)	\$27,549.04	
Key employee benefits percentage =	$\frac{\text{Aggregate benefits of key employees}}{\text{Aggregate benefits of all employees}}$	$\frac{\$12,240.96}{\$27,549.04}$	= 44.43%

Test Result: FAIL

1. Take the benefits of all Key employees divided by the benefits of ALL employees = **Cannot exceed 25%**

“Key” employees defined as:

- Officer w/ Compensation over \$175,000
- More than 5% Owner –OR–
- More than 1% Owner w/ Compensation over \$150,000

WHAT IS NDT?

SELF-INSURED PLAN TESTING*

- 1) **Eligibility Test:** ensures that a reasonable percentage of non-Highly Compensated Employees benefit from the plan.
- 2) **Benefits Test:** all benefits provided for participants who are HCEs must be provided for all other participants.

*Health FSA Plans, HRA Plans

2.1 THE ELIGIBILITY TEST

1. 70% Test:

Total benefitting employees (divided by) total number of employees = **should be more than 70%**

2. 70%/80% Test:

Percentage of employees eligible to benefit = should be more than 70%

Percentage of employees actually benefitting = should be 80%

Plan must benefit 80% of employees if 70% of employees are eligible

3. If the Plan's Ratio Percentage is 50% or more, plan automatically passes

Non- Highly Compensated Individual Benefiting Percentage (divided by) Highly Compensated Individual Benefiting Percentage = **should be 50% or higher**

WHAT IS A BENEFITTING EMPLOYEE? To “benefit” means the contribution amount is greater than “0” in the data provided.

HEALTH FSA

2.1 – The Eligibility Test

(PERCENTAGES)

- Must pass one of the following three tests

The 70% Test - Alternative #1 of 3 Eligibility Test			
Percentage of employees benefitting =	$\frac{\text{Total Benefitting employees}}{\text{Total number of non-excludable employees}}$	$\frac{9}{100}$	= 9.00%
The 70%/80% Test - Alternative #2 of 3 Eligibility Test			
Percentage of employees eligible to benefit =	$\frac{\text{Total Eligible employees}}{\text{Total number of non-excludable employees}}$	$\frac{100}{100}$	= 100.00%
Percentage of eligible employees who are benefitting =	$\frac{\text{Total Benefitting employees}}{\text{Total Eligible employees}}$	$\frac{9}{100}$	= 9.00%
Post-TRA Nondiscriminatory Classification Test - Alternative #3 of 3 Eligibility Test			
Non-highly Compensated Individual Concentration Percentage =	$\frac{\text{Total non-excludable NHCIs}}{\text{Total non-excludable employees}}$	$\frac{75}{100}$	= 75.00%
Safe Harbor Percentage =	(According to Table)	38.75%	
Unsafe Harbor Percentage =	(According to Table)	28.75%	
Highly Compensated Individual Benefitting Percentage =	$\frac{\text{Benefitting HCIs}}{\text{Total non-excludable HCIs}}$	$\frac{8}{25}$	= 32.00%
Non-highly Compensated Individual Benefitting Percentage =	$\frac{\text{Benefitting NHCIs}}{\text{Total non-excludable NHCIs}}$	$\frac{1}{75}$	= 1.33%
Plan's Ratio Percentage =	$\frac{\text{Benefitting NHCIs \%}}{\text{Benefitting HCIs \%}}$	$\frac{1.33\%}{32.00\%}$	= 4.17%

DCAP NONDISCRIMINATION TESTING

Four specific DCAP nondiscrimination tests:

- *Eligibility Test*: A DCAP must not discriminate in favor of HCEs or their dependents as to eligibility to participate
- *Contributions and Benefits Test*: A DCAP must not discriminate in favor of HCEs or their dependents as to contributions and benefits received under the plan
- *More-Than-5% Owners Concentration Test*: Not more than 25% of the amounts paid or incurred by the employer for dependent care for a plan year may be provided to shareholders or owners (or their spouses or dependents) who own more than 5% in the stock, capital, or profits interest in the employer
- *55% Average Benefits Test*: The average DCAP benefits provided to the non-HCEs under all plans of the employer must be at least 55% of the average benefits provided to HCEs under all plans of the employer



DCAP NONDISCRIMINATION TESTING

Highly Compensated Employee (HCE) (Who is in the Prohibited Group?)

HCEs under Code §414(q) are:

- Employees whose comp during the preceding plan year exceeded the HCE compensation threshold for that year (For 2016 and 2017, it is \$120,000) or
- Employees who were more-than-5% owners in the current or preceding plan year



DCAP NONDISCRIMINATION TESTING

Eligibility Test – First of 4

Who is in the Prohibited Group?

HCEs

Who must be included in the Testing Group?

All employees (including leased employees) of the plan sponsor and any other related business(es)

Who can be excluded from the Testing Group?

Employees who have not attained age 21

Employees who have not completed a year of service

CBA covered employees who are excluded from participation

*No safe harbors



DCAP NONDISCRIMINATION TESTING

Eligibility Test

Many employers automatically pass the Eligibility Test by plan design

If all employees are eligible to participate in the DCAP, the plan will automatically pass the Eligibility Test

If only certain classes of employee are eligible then a plan satisfies the Nondiscriminatory Classification Test only if—

- the plan benefits employees who qualify under a reasonable classification established by the employer (the classification must be based on objective business criteria that identify the category of employees who benefit); and
- the classification of employees is nondiscriminatory (a percentage test is used under Code §410(b)).



DEPENDENT CARE

3.1 Eligibility

(PERCENTAGES)

- Nondiscriminatory if the plan's ratio percentage is 50% or more

Non-highly Compensated Individual (NHCI) Concentration Percentage	$\frac{\text{Total NHCI}}{\text{Total employees}}$	$\frac{6}{22}$	= 27.27%
Safe Harbor Percentage	(According to Table)	50.00%	
Unsafe Harbor Percentage	(According to Table)	40.00%	
Highly Compensated Individual (HCI) Benefiting Percentage	$\frac{\text{Eligible HCIs}}{\text{Total HCIs}}$	$\frac{16}{16}$	= 100.00%
Non-highly Compensated Individual (NHCI) Benefiting Percentage	$\frac{\text{Eligible NHCIs}}{\text{Total NHCIs}}$	$\frac{2}{6}$	= 33.33%
Plan's Ratio Percentage	$\frac{\text{Benefiting NHCIs \%}}{\text{Benefiting HCIs \%}}$	$\frac{33.33\%}{100.00\%}$	= 33.33%

Test Result: FAIL

1. Eligible HCE's (divided by) Total HCE's = Percentage #1
2. Eligible non-HCEs (divided by) Total non-HCEs = Percentage #2

DCAP NONDISCRIMINATION TESTING

Contribution and Benefits Test (Second of Four)

Are HCEs or their dependents eligible to receive better benefits or authorized to make lower contributions for equal benefits to non-HCEs?

The test is subjective, requiring that HCEs or their dependents not be offered better benefits or equal benefits on better terms. However, the test is not a utilization test.



DCAP NONDISCRIMINATION TESTING

More-Than-5% Owners Concentration Test (Third of Four)

The More-Than-5% Owners Concentration Test ensures that certain HCEs (*i.e.*, the more-than-5% owners) and their family members don't receive more than 25% of the DCAP benefits

Mechanics of test:

DCAP benefits provided to more-than-5% owners cannot exceed 25% of benefits provided for all employees.



3.3 More than 5% Owners

(PERCENTAGES)

- DCAP benefits provided to more-than-5% owners cannot exceed 25% of the benefits provided for all employees under the plan

Annual DCAP contribution of 5% owners = *(According to input data)* \$2,496.00

Annual DCAP contribution of all employees = *(According to input data)* \$8,472.00

$$\begin{array}{rcl} \text{Annual DCAP contribution of 5\% owners percentage} & = & \frac{\text{DCAP contribution of 5\% owners}}{\text{DCAP contribution of all employees}} = 29.46\% \\ & & \frac{\$2,496.00}{\$8,472.00} \end{array}$$

Test Result: FAIL

1. DCAP Contributions of 5% Owners (divided by) DCAP Contributions of ALL Employees = **cannot exceed 25%**

DCAP NONDISCRIMINATION TESTING

55% Average Benefits Test (Fourth of Four)

The 55% Average Benefits Test ensures that HCEs do not participate disproportionately

This test focuses on the average (per capita) benefit received by HCEs as compared to that received by non-HCEs

Mechanics:

Average benefit to non-HCEs must be at least 55% of average benefit provided to HCEs



3.4 - 55% Average Benefits

(PERCENTAGES)

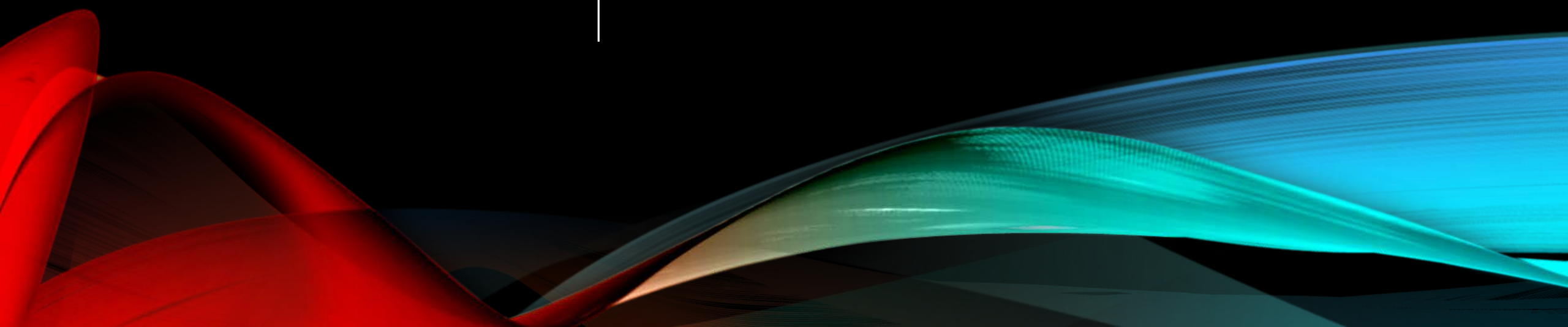
- Is meant to ensure that HCEs do not participate disproportionately. The 55% Average Benefits Test focuses on the average benefit received by HCEs as compared to that received by non-HCEs
- A plan meets the requirements if the average benefits provided to non-HCEs is at least 55% of the average provided to HCEs

	<i>Total Contributions of Non-Excludable NHCEs</i>	\$15,000.00	
Average Annual DCAP Contribution of NHCE =	<hr/>		= \$319.15
	<i>Total Non-Excludable NHCEs</i>	47	Dollar Amount #1
	<i>Total Contributions of Non-Excludable HCEs</i>	\$15,000.00	
Average Annual DCAP Contribution of HCE =	<hr/>		= \$1,500.00
	<i>Total Non-Excludable HCEs</i>	10	Dollar Amount #2
	<i>Average Annual DCAP Contribution of NHCE</i>	\$319.15	
NHCE Employees Annual DCAP Percentage =	<hr/>		= 21.28%
	<i>Average Annual DCAP Contribution of HCE</i>	\$1,500.00	
55% Threshold for Average Annual DCAP Contribution of NHCE =	<i>Average Annual DCAP Contribution of HCE x 55%</i>	\$825.00	
60% Threshold for Average Annual DCAP Contribution of NHCE =	<i>Average Annual DCAP Contribution of HCE x 60%</i>	\$900.00	

Test Result: FAIL

IRC Section 105

SELF-FUNDED PLANS



SELF-INSURED NONDISCRIMINATION TESTING

Code §105(h) rules apply to a self-insured medical reimbursement plans

Two tests must be satisfied:

- Under **the Eligibility Test**, the plan can't discriminate in favor of HCs as to eligibility to participate. Three alternative tests—the 70% Test, the 70%/80% Test, and the Nondiscriminatory Classification Test (which itself consists of two alternative tests).
- Under **the Benefits Test**, the benefits provided under the plan must not discriminate in favor of HCs. There are two requirements—nondiscriminatory benefits on the face of the plan and nondiscriminatory benefits in operation

*Health FSAs offered under a cafeteria plan are also subject to cafeteria plan NDT rules under 125



SELF-INSURED NONDISCRIMINATION TESTING

Eligibility Test (First of two)

Prohibited Group (Who's a Highly Compensated Individual?)

“Highly Compensated Individual” is defined as an individual who is—

- One of the five highest-paid officers (current plan year);
- a shareholder who owns more than 10% of the value of the employer's stock (attribution applies); or
- among the highest-paid 25% of all employees (other than excludable employees who are not participants)



SELF-INSURED NONDISCRIMINATION TESTING

Eligibility Test

Self-insured plans may pass under any one of three alternative tests:

- *70% Test*. The plan benefits 70% or more of all nonexcludable employees.
- *70%/80% Test*. The plan benefits 80% or more of all nonexcludable employees who are eligible to benefit, if 70% or more of all nonexcludable employees are eligible to benefit under the plan.
- *Nondiscriminatory Classification Test*. The plan benefits a nondiscriminatory classification of employees. This requires (1) a bona fide business classification for any exclusion; and (2) a sufficient ratio of benefiting non-HCIs to benefiting HCIs.

*No safe harbors or exceptions (CBA covered employees are excludable)



HRAs

4.1 Eligibility

(PERCENTAGES)

- Must pass one of three tests

The 70% Test - Alternative #1 of 3 Eligibility Test			
Percentage of employees benefitting =	$\frac{\text{Total Benefitting employees}}{\text{Total number of non-excludable employees}}$	$\frac{9}{100}$	= 9.00%
The 70%/80% Test - Alternative #2 of 3 Eligibility Test			
Percentage of employees eligible to benefit =	$\frac{\text{Total Eligible employees}}{\text{Total number of non-excludable employees}}$	$\frac{100}{100}$	= 100.00%
Percentage of eligible employees who are benefitting =	$\frac{\text{Total Benefitting employees}}{\text{Total Eligible employees}}$	$\frac{9}{100}$	= 9.00%
Post-TRA Nondiscriminatory Classification Test - Alternative #3 of 3 Eligibility Test			
Non-highly Compensated Individual Concentration Percentage =	$\frac{\text{Total non-excludable NHCI}}{\text{Total non-excludable employees}}$	$\frac{75}{100}$	= 75.00%
Safe Harbor Percentage =	(According to Table)	38.75%	
Unsafe Harbor Percentage =	(According to Table)	28.75%	
Highly Compensated Individual Benefitting Percentage =	$\frac{\text{Benefitting HCIs}}{\text{Total non-excludable HCIs}}$	$\frac{8}{25}$	= 32.00%
Non-highly Compensated Individual Benefitting Percentage =	$\frac{\text{Benefitting NHCI}}{\text{Total non-excludable NHCI}}$	$\frac{1}{75}$	= 1.33%
Plan's Ratio Percentage =	$\frac{\text{Benefitting NHCI \%}}{\text{Benefitting HCIs \%}}$	$\frac{1.33\%}{32.00\%}$	= 4.17%

Test Result: FAIL

1. 70% Test:

Total benefitting employees divided by total number of employees = should be more than 70%

2. 70%/80% Test:

Percentage of employees eligible to benefit = should be more than 70%

Percentage of employees actually benefitting = should be 80%

Plan must benefit 80% of employees if 70% of employees are eligible

3. If the Plan's Ratio Percentage is 50% or more, plan automatically passed

Non- Highly Compensated Individual Benefitting Percentage (divided by) Highly Compensated Individual Benefitting Percentage = should be 50% or higher

SELF-INSURED - NDT TESTING

Benefits Test (Second of two)

Are all participants eligible for the same benefits?

Plans must address the following issues:

- Are all participants eligible for the same benefits under the plan?
- Are all benefits offered under the same conditions to all participants?
- If optional benefits are offered, are all participants able to elect each benefit option for the same additional contribution?
- Are disparate waiting periods being used?
- Do benefits vary based on age, years of service, or compensation?

SELF-INSURED NONDISCRIMINATION TESTING

Benefits Test (Second of Two)

Who is in the Prohibited Group?

HCI: the five highest-paid officers, more-than-10% shareholders, and the highest-paid 25% of all employees

Who is included in the Testing Group?

Only employees participating in the plan



SELF-INSURED NONDISCRIMINATION TESTING

Benefits Test

What Happens If a Health FSA Fails the Benefits Test?

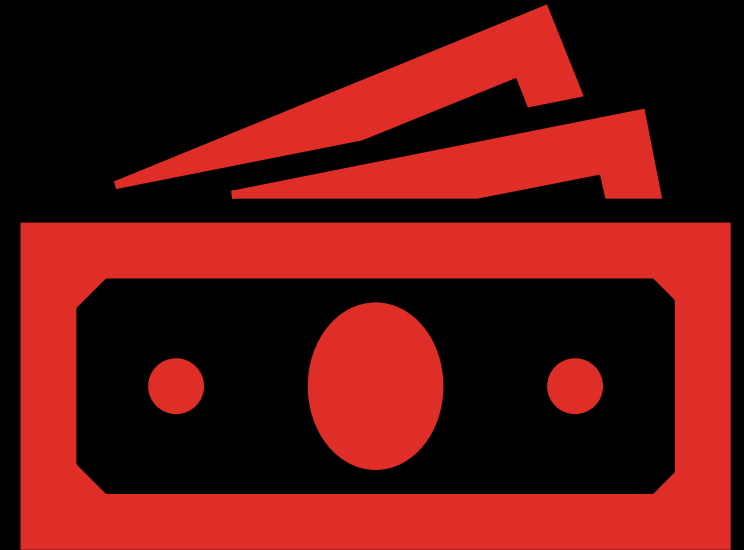
If a health FSA is discriminatory as to benefits, the HCIs will lose their income tax exclusions on any discriminatory benefits paid to them under the plan (called "excess reimbursements")



PENALTIES FOR NON-COMPLIANCE

PENALTIES FOR NON-COMPLIANCE

- Self-Funded Medical
 - HCE must include excess reimbursement in taxable income
- Section 125 Cafeteria Plan
 - HCEs or Key Employees will include elections/reimbursements in taxable income
- Dependent Care Accounts
 - HCEs will include all Dependent Care elections as taxable income



RECOMMENDATIONS

Seeking Successful Results



ELIGIBILITY TEST FAILURE

- More HCE participate than Non-HCE
 - Increase number of non-HCE participants
 - Decrease number of HCE participants
 - Limiting eligibility
 - Auto enrolling all eligible employees by offering 100% employer paid options.

DCAP FAILURE

55% average test failure

- Prohibit HCE from electing coverage
- Limit HCE's elections
 - Constant monitoring required
 - Mid year election changes

25% Owner Concentration failure

- Prohibit >5% from electing
- Limit >5% to a % of Non HCE election
 - Constant monitoring
 - Mid year election changes

SECTION 125 FAILURE

Utilization Test

- Increase participation among non HCE
- Avoid 100% employer paid single insurance premiums
- HCE pay post tax for insurance

Availability Test

- Fails if HCE offered select option
 - Better insurance plans
 - Additional insurance plans

25% CONCENTRATION TEST (KEY EMPLOYEE TEST)

- Prohibiting key employees from electing
- Avoid 100% employer paid single insurance premiums
- HCE pay post tax for insurance
- Wait on HSA contribution until end of plan year



QUESTIONS?

James Ingle

jingle@primepay.com

860 740 7420

