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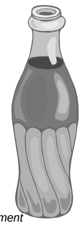
# Don't Let Your POP Lose Its Fizz

*Preserving the Tax Benefits of Premium Only Cafeteria Plans*

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*The Internal Revenue Service requires us to state that advice contained in this document is not intended or written by the writer to be used, and cannot be used by the reader, for the purpose of avoiding penalties under the Internal Revenue Code.*



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# WELCOME

**About me and the firm…**

Scott E. Galbreath

- SNSFE Partner
- Helping businesses save money, attract talented employees, and better compensate key players through employee benefit plans for 20 years
- Write and speak often about employee benefits. Spoke on new Roth 401k accounts on 4/28. Will do again in July. May 23 speaking on purchasing real estate through IRA or 401k.
- B.A. high honors, Elmhurst College; J.D. and LL.M. (Tax) with honors from IIT Chicago-Kent College of Law

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- Full service business law firm established in 1960
- "AV" Peer Review Rated
- Representing closely-held businesses, entrepreneurs, and individuals
- Start-up to succession planning
- Our mission is to provide legal services that provide genuine business benefits, on time and on budget

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# Why are we here?

- Employers don't fully understand the operation of a POP
- Can lead to adverse tax consequences
- IRS is increasing enforcement efforts in benefits area
  - Increased budget
  - Hired more agents for audits
  - Increasing audits

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## What is a POP?

- Legal answer: A Code Sec. 125 cafeteria plan of an ER offering EEs the choice between receiving cash or converting the cash to pay for the EE portion of health care on a pre-tax basis
- Simple answer: A plan allowing EEs to reduce salary to pay their share of health care premiums on a pre-tax basis



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## What is a cafeteria plan?

- A written plan of the ER that offers EEs a choice between cash and one or more nontaxable benefits
- Subject to certain nondiscrimination rules
  - Designed to ensure lower paid EEs benefit as well as higher paid

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## Two Types of Prohibited Discrimination

1. In favor of Highly Compensated Employees (HCEs)

2. In favor of Key Employees

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## Who is an HCE?

- An officer
- A > 5% owner this year or last year (including constructive owners)
- In prior year earned $100K
  - and, if elected by ER, was in top 20% paid group
- A spouse or dependent of any of the above



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## Constructive Ownership

- Family- spouse, children, grandchildren, and parents
- Entities- partnership, S-corp, estate, and trusts
- 50% owned corporation
- Options



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## 2 HCE Discrimination Tests

- Eligibility
- Contributions and Benefits

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## HCE Discrimination Tests-Eligibility

Safe harbors:

1. Collective bargaining
2. Nondiscriminatory class
   - No more than 3 years to participate
   - Participate first day of first plan year after meet eligibility



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## HCE Discrimination: Nondiscriminatory Class

- Safe Harbor Test
  - Reasonable classification
  - Cover a safe harbor percentage of NHCEs
  - A numeric formula comparing the ratio of NHCEs participating with the ratio of HCEs participating
  - If up to 60% of all EEs are NHCEs, then if the % of NHCEs covered is at least 50% of the % of HCEs covered then nondiscriminatory
  - 50% number is reduced .75% for each 1% above 60%



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## Example

- All full time employees are eligible and covered
- 10 full time employees
- 2 HCEs
- 8 NHCEs
- 80% of employees are NHCEs
- 100% HCEs covered, 100% NHCEs

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## Eligibility-Facts and Circumstances

- Above the unsafe harbor test
  - Cover a minimum percentage of NHCEs
  - Starts at 40% and reduced .75%
- IRS determines does not discriminate



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## HCE Discrimination Tests- Contributions and Benefits

- Contributions- Plan must not discriminate in favor of HCE with respect to nontaxable benefits (or ER contributions allocable to such) or total benefits (or ER contributions allocable to such).



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## Contributions and Benefits 100/75 Safe Harbor for Health

- Deemed nondiscriminatory if:
- (A) contributions for each participant-
  - (i) equals 100% of the cost of the health benefit coverage of the majority of the HCEs similarly situated, or
  - (ii) equals or exceeds 75% of the cost of the health benefit coverage of the participant (similarly situated) having the highest cost health benefit coverage under the plan, and
- (B) contributions or benefits under the plan in excess of those described above bear a uniform relationship to compensation.

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## Similarly Situated: Example

- Single coverage is $150/month, family coverage is $400
- Need not compare HCEs family coverage with NHCEs single coverage
- Do compare like coverages



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## Similarly Situated: Example

- 3 HCEs with Family, 2 NHCEs Family
- 1 HCE Single, 12 NHCEs Single
- Each NHCE's benefit is 100% of HCEs similarly situated
- Gets a little trickier with multiple plan options such as HMO, PPO, POS to choose from.



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## Key EE Discrimination: the Concentration test

- Tests benefits provided "Key employees"
- If the nontaxable benefits provided Key employees under the plan exceed 25% of the total benefits under the plan, Key employees will be taxed.

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## Who is a Key EE?

- At any time during plan yr or 4 prior plan years:
- >5% owner
- >1% owner with > $150K in compensation
- An officer with > $140K in compensation
- Constructive ownership rules apply



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## Concentration Test Ex.

- Employer pays 75% of the premium, employees pay 25%
- 2 50% owners with family coverage
- 9 NHCEs (2 single, 5 with family, 2 with none)
- EE family coverage = $400/mo
- EE single coverage = $150/mo
- Total family = $2,800 Total single = $300
- Key EEs = $800/$3,100 or 25.8%



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## Continuation Coverage

- 3 Federal Statutes (plus state laws)
- COBRA- ERs with > 20 EEs
- USERRA- applies to all employers
- FMLA- ERs with > 50 EEs

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## Continuation Coverage-USERRA

- If 30 days or under:
  - Health coverage like actively employed
- If more than 30 days:
  - Can elect coverage for lesser of:
  - service + time to re-apply; or
  - 24 months



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## USERRA Notice

- USERRA encourages Notice
- Excuses lack of notice due to “military necessity”
  - Military decides
- Also excuses circumstances when it may otherwise be impossible or unreasonable for EE to give notice.
  - Facts and circumstances



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## USERRA > 30 Days Election

- If give notice but doesn’t elect:
- ER may terminate coverage but EE may elect retroactive coverage at any time during service provided pays premiums
  - Unless ER has reasonable procedures for electing and paying for USERRA coverage
  - COBRA compliant procedures may be considered reasonable
  - Unless Lack of Notice is excused

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## Take Aways

- POP allows EEs to pay premiums pre-tax
- Must have written plan
- Must have EE elections
- Plan must be tested annually for discrimination
- Plan should address continuation coverage
  - USERRA applies to all ERs



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## SNSFE POP Review

- $500 Prepaid
- Send engagement letter and questionnaire
- Client provides information/documentation
- Review form and operation
- Prepare a report to:
  - Identify noncompliance
  - Identify areas needing improvement
  - Work plan showing what, when, estimated hours and fees to correct/improve
    - unless unusual circumstances



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## SNSFE POP Review

Yes, I want to take advantage of the SNSFE offer to initially review my POP for $500. Upon receipt of my $500 and this form, SNSFE will send me an engagement letter and questionnaire setting forth the required information. I understand that the review is dependent on me providing the required information. I further understand that the review will only result in identifying issues and recommended solutions or strategies with a work plan for implementation. Fees for implementation will be in addition to the review fee.

Company name: ________________________________________
Address: _____________________________________________
Email: _______________________________________________
Phone: _______________________________
Contact person: ________________________________________

________________________________
Signature

Mail to: Shaheen, Novoselsky, Staat, Filipowski & Eccleston, P.C., c/o Scott E. Galbreath, 20 N. Wacker Drive, Suite 2900, Chicago, IL 60606.

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# Thank You


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