

Compliance Reminders for Nondiscrimination Testing and Form 5500 Filing Obligations

Introduction

As benefits administration becomes more and more complicated, compliance is on everyone's to-do list. In the compliance world of never-ending change, the following is a refresher course for employers on two of the compliance requirements of Internal Revenue Code (IRC) §125 cafeteria plans and IRC §105 that *haven't* changed: nondiscrimination testing and Form 5500 filing obligations.

Nondiscrimination testing rules are generally designed by and specified within the IRC to ensure that plans are not designed in such a way that they discriminate in favor of highly paid employees (HCEs) or certain key employees within the organization (e.g., owners and managers). These tests, in turn, help make sure the contributions made by and for non-highly compensated employees (NHCEs) are proportional to contributions made for HCEs.

These tests, which apply to employer clients who offer plans governed by IRC §§ 125, 129, and/or 105 (such as cafeteria plans, Healthcare Flexible Spending Accounts (FSA), Dependent Care Flexible Spending Accounts, Health Reimbursement Arrangements (HRA), and Health Savings Accounts with contributions made through a section 125 cafeteria plan), can best be organized into three basic groupings:

- *Eligibility.* If too many NHCEs are excluded from participation in the plan, then it will be discriminatory.
- *Availability of Benefits.* The plan will not pass the nondiscrimination tests if the HCEs/key employees can access more or better benefits than NHCEs.
- *Utilization.* A plan will not pass the nondiscrimination tests if the HCEs/key employees actually elect more benefits under the plan.

What are Nondiscrimination Tests?

The overall “25% Concentration Test” compares all the pre-tax benefits elected by key employees with all the pre-tax benefits elected by non-key employees. Not more than 25% of the total benefits elected by all employees may be attributed to key employees.

Example:

All elections to the cafeteria plan add up to \$35,000. Of those total elections, key employee elections equal \$5,000. Key employee elections are about 14% of the total elections to the plan (i.e., $\$5,000 / \$35,000 = 14.3\%$). In this example, the cafeteria plan passes the 25% Concentration Test.

The “55% Average Benefits Test” involves only the dependent care portion of the cafeteria plan. The average dollar amount of benefits elected by non-highly compensated employees must be at least 55% of the average dollar amount of benefits elected by highly compensated

employees.

Example:

Assume that highly compensated employees' elections are \$10,000 to the dependent care portion of the plan and there are five highly compensated employees in the company. Non-highly compensated employees elect \$19,500 to the dependent care portion of the plan and there are 13 non-highly compensated employees. The highly compensated average dollar amount is \$2,000 ($= \$10,000 / 5$). The non-highly compensated average dollar amount is \$1,500 ($= \$19,500 / 13$). The average dollar amount of benefits elected by non-highly compensated employees is 75% of the average dollar amount of benefits elected by highly compensated employees ($\$1,500 / \$2,000$). In this example, the dependent portion of the cafeteria plan passes the 55% Average Benefits test.

The "5% Owner Test" compares the dependent care benefits elected by more-than-5% owners of a company with dependent care benefits elected by non-owners. Not more than 25% of the total dependent care benefits elected by everyone in the dependent care benefit may be attributed to more-than-5% owners.

Example:

Assume a \$5,000 election to the dependent care portion of the plan by a more-than-5% owner and elections in the amount of \$19,500 made by all non-owners. The more-than-5% owner's election is 20% of the total benefits elected to the dependent care portion of the plan ($20\% = \$5,000 / (\$24,500 [= \$5,000 + 19,500])$). In this case, the dependent care portion of the plan passes the 25% Owner test because only 20% of the dependent care benefits were elected by the more-than-5% owner.

The "Eligibility, Benefits Available, and Contribution and Benefits" Tests ensure that employers offer all benefits to an adequate number of employees and benefits do not discriminate in favor of highly compensated or key employees.

In the event the plan does not meet all the nondiscrimination requirements, employers may need to change benefit elections and payroll amounts to bring the plan into compliance. It is important to test prior to the end of the plan year. If testing is completed after the end of the plan year, it's too late to take corrective action. Instead of reducing key or highly compensated elections in order to pass the nondiscrimination test(s), the affected employees would be taxed on their total election amount.

Form 5500 Obligation

A frequently overlooked responsibility for plan sponsors is Form 5500 filings under certain circumstances. In 2002, IRS Notice 2002-24¹ suspended the filing requirement imposed on cafeteria and fringe benefit plans. However, don't be misled! The filing requirement for welfare benefit plans remains unchanged.

What is a welfare benefit plan?

Welfare benefit plans provide benefits such as medical, dental, life insurance, apprenticeship

and training, scholarship funds, severance pay and disability. FSAs contained inside cafeteria plans and HRAs qualify as welfare benefit plans.

Who must file a Form 5500?

Employers that sponsor welfare benefit plans covered by Title I of the Employee Retirement Income Security Act of 1976 (ERISA), with 100 or more participants at the beginning of the plan year, are required to file a Form 5500 for those plans. However, there are a couple of exceptions that apply, depending on the type of employer sponsoring the plan.

A general exception applies to:

- a governmental plan ERISA § 4(b)(1); or
- a church plan under ERISA § 4(b)(2).

The plan *may* not be exempt from filing if:

- it is deemed to have plan assets;
- plan funds are separated from the employer's general assets;
- plan funds are held in trust; or
- plan funds are forwarded to a Third-Party Administrator.

Most non-exempt employer plans will complete all questions on Form 5500. Depending on the funding arrangement or payments from the plan, attaching Schedules may be applicable.

Since 2009, however, the "Instructions for Form 5500" have been modified to make clear that plans that are paid from the general assets of the employer need not file Schedule C.

When does a welfare benefit plan need to file a Form 5500?

Forms must be filed by the last day of the seventh calendar month after the end of the plan year. A plan may obtain a one-time extension of time to file. Form 5558 must be sent by the original due date in order to gain a 2½ month extension of time in which to complete and file the Form 5500.

Closing

Please contact HealthEquity if you have questions about nondiscrimination testing or would like HealthEquity to complete nondiscrimination testing or Form 5500 services for your HealthEquity administered benefit plan.

The preceding general summary is intended to educate employers and plan sponsors on the potential effects of government guidance on employee benefit plans. This summary is not and should not be construed as legal or tax advice. As always, we strongly encourage employers and plan sponsors to consult competent legal or benefits counsel for all guidance on how the actions apply in their specific circumstances.