Cafeteria Plans in General

A cafeteria plan is an employer-sponsored plan that allows employees to choose certain pre-tax benefits or cash. For example, an employee may choose to pay his or her share of premiums for employer-sponsored health insurance before taxes through the plan.

A cafeteria plan must have a written plan document governing the plan and may not discriminate in favor of highly compensated or key employees. To ensure compliance with the nondiscrimination rules, plan sponsors are required to perform several nondiscrimination tests each plan year.

Eligible Employer Definition

Under The Patient Protection and Affordable Care Act of 2010, a small employer is any employer that had, on average, 100 or fewer employees on business days during either of the two preceding years. If an employer was not in existence during the prior year, the number of employees is based on the average number of employees that is reasonably expected to be employed on business days during the current year.

The act contains a provision for growing businesses that allows employers who offer a simple cafeteria plan in a qualifying year and then subsequently grow beyond 100 employees to maintain that plan in subsequent years. A growing employer may continue the simple cafeteria plan until the employer exceeds an average of 200 or more employees during a preceding year.

Eligibility, Participation, and Contribution Requirements

To establish and maintain a simple cafeteria plan, an eligible small employer must design its plan to meet the following requirements:

Eligibility and Participation Requirements

- All employees with at least 1,000 hours of service during the preceding plan year must be eligible to participate in the plan (other than employees that may be excluded, as outlined below).

- Each employee who is eligible to participate in the plan must have the right, subject to terms and conditions applicable to all participants, to elect any benefit available under the plan.

Allowable Exclusions

The act allows employers to exclude the following employees from participating in the plan:

- Employees who have not attained the age of 21 before the close of the plan year

- Employees who have less than one year of service with the employer as of any day during the plan year

- Employees covered under a collective bargaining agreement if there is evidence that the benefits covered under the plan were the subject of good faith bargaining between employee representatives and the employer

- Employees described in Code Section 410(b)(3)(c) (relating to non-resident aliens working outside the United States)

Contribution Requirements

The employer must make a contribution to provide qualified benefits under the plan on behalf of each qualified employee, regardless of the whether the employee makes a contribution of their own. This contribution amount must be in an amount equal to:

- A uniform percentage (not less than 2 percent) of the employee's compensation for the plan year, or

- An amount which is not less than the lesser of:

    - 6 percent of the employee's compensation for the plan year, or

    - Twice the amount of the salary reduction contributions of each qualified employee

- The rate of matching contributions made by the employer on behalf of highly compensated or key employees cannot be greater than the rate of matching contributions for non-highly compensated or key employees.

Qualified, Highly Compensated and Key Employees Defined

For the purposes of the act, a qualified employee is any employee who is eligible to participate in the cafeteria plan and is not a highly compensated or key employee.

The term "highly compensated employee" is defined in Code Section 414(q). The income limitation for highly compensated employees is adjusted from time to time and is currently set at $110,000. The term "key employee" is defined in Code Section 416(i).

The Benefits of Establishing a Simple Cafeteria Plan

Under the act, simple cafeteria plans are exempt from the Code Section 125 nondiscrimination requirements as well as the nondiscrimination requirements applicable to the plans offered through the cafeteria plan (for example, Code Section 129 non-discrimination testing for dependent care FSAs, Code Section 105(h) nondiscrimination testing for self-insured medical plans, etc). Because the sponsor of a simple cafeteria plan is not required to perform nondiscrimination testing, the administrative burden of offering the plan is lessened; making it is easier for small employers to offer a plan to their employees.