PCRB

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PREMIUM AUDIT TREATMENT OF CAFETERIA PLANS AND FLEXIBLE BENEFITS

Flexible Benefit Plans

The term "Flexible benefit plans" contemplates "cafeteria plans," tax exempt salary deferrals for "out-of-pocket" medical, legal, dependent care, day care expenses, etc. In other instances, employers may make certain amounts of money available to each employee and suggest such funds be used to purchase group insurance through the company. In some instances the employee will use these funds to secure group insurance coverage, but in other instances group insurance coverage is declined. This is prevalent when a working spouse is providing group coverage for the spouse or family through another employer policy.

There are three general types of flexible benefit plans:

1. Core-Plus Plan
2. Modular Plan
3. Flexible Spending Account

Cafeteria Plan Specifications

Cafeteria plans must be written benefit plans under which all participants are employees who can choose among cash and certain qualified benefits. The written plan must state eligibility requirements. The plan must specify benefit election procedures. Employees must select coverage and salary reduction amounts in advance of earning the salary. This is the means by which IRS recognizes the reduction as nontaxable since the employee does not constructively have the option of receiving cash after the elections have been made.

The method of payment for the benefits must be spelled out. The benefits could be paid for directly by the employer, by salary reduction, or by any combination of the two methods. For audit purposes this written plan should be reviewed to determine that salary reduction amounts are indeed for a qualifying cafeteria plan.

Finally, the employer must submit an annual return specifying the costs of operating the plan. Although the breakdown of costs by benefits are not required on the return, the employer must keep records in a manner which would make this information available at the request of the Secretary of the Treasury. This means the auditor should be able to <u>reconcile</u> the salary reductions applicable to the plan.

Remuneration: Insurance Treatment Of Flexible Benefit Plans

Many of these plans are funded through salary reduction rather than paid directly by the employer. Some policyholders and their advisors will contend that the salary reductions are deductible for purposes of determining the Workers' Compensation basis of premium.

Pennsylvania Manual Rule V-B-3-a excludes from remuneration those premiums paid by the employer to a group insurance program but does not exclude the group insurance premium paid by the employee. Therefore, when the employee pays a portion of the group insurance premiums, or when he or she makes "cafeteria plan" purchases, such employees amounts shall be considered as remuneration for Workers' Compensation insurance premium purposes.

Example: Let us assume three employees each earn $15.00 per hour; the employer provides a basic A & H policy to cover only the employee; and the following is determined at audit.

1. The first employee is single and does not desire dental or vision coverage. Therefore, he does not make any additional purchases and receives $15.00 per hour in his pay check.

2. The second employee is married but has no children. Therefore, he desires coverage for himself and his spouse PLUS dental coverage. Since additional "group insurance coverage" is provided AT THE EMPLOYEE'S EXPENSE, $1.00 per hour is being deducted to pay for the additional desired coverages.

3. The third employee has a wife and three children. Therefore, he desires coverage for the spouse and children PLUS dental and vision coverage. Accordingly, his salary is being reduced by $2.00 per hour to pay for the desired additional coverages.

In all THREE examples, the "amount paid by the insured for the services of employees covered by the policy" (Basic Manual Rule V) would be $15.00 per hour. Therefore, the employee's salary BEFORE reduction is the amount to be audited for Workers' Compensation insurance premium purposes.

There are also situations where an employer had agreed to pay each employee a specific amount annually and suggested such amounts be used to purchase group insurance coverage which was available through the company. However, if the employee was insured under a spouse's group insurance policy, or simply did not desire coverage for whatever reason, the money would be paid directly to the employee. In this instance, if the employee uses all of the money to purchase group insurance coverage, such amounts would not be audited as remuneration for Workers' Compensation insurance purposes. However, any unspent portion received by the employee would be considered to be remuneration. Likewise, should the employee exceed the allowable amount, any further payment by salary reduction (or other method) would also be considered as remuneration.

Another variation of a flexible benefit plan may involve child day care expenses wherein the employer, or employee, would pay the billed day care expenses but the employer would reduce the employee's taxable income by such paid amounts. These amounts should also be considered as remuneration.

The qualification of salary reduction amounts pertains to the written and filed plan specifications. Deductions from the basis of premium will only be permitted for those amounts contributed by the employer for group insurance as defined in the plan filed with the Internal Revenue Service. If the employee contributes additional money, no deduction from the premium basis is appropriate.