Your Key to Savings

Explore and understand the tax-saving advantages offered in your Premium Only Plan (POP)!
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Supporting Documents

- Enrollment Form
- Quick Reference Guide (English)
- Quick Reference Guide (Spanish)
- Employee Request for Service

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CONGRATULATIONS!

You are about to implement a group benefit plan that can provide tax savings for both you and your employees. A Premium Only Plan, or POP, allows employees to lower their taxable income by paying for qualified benefits with pre-tax dollars. When employees’ benefits are paid pre-tax, your company’s payroll tax (FICA, etc.) liability is also lowered. A POP plan provides a win-win for everyone!

Benefits You Can Offer on a Pre-Tax Basis with Your POP Plan

The federal tax code (often just called “the Code”) requires that workers pay a certain percentage of the income they earn to the Internal Revenue Service. The Code also exempts certain items from taxation, allowing employees to pre-tax premium payments for items such as:

- Health Insurance
- Dental Insurance
- Vision Insurance
- Disability Insurance
- Group Term Life Insurance (up to $50,000)
- Various Supplemental or Voluntary Insurance Programs

By pre-taxing these insurance premiums, employees lower their tax liability while also enjoying the benefit of insurance for themselves, their spouses, and their dependents. Consider an employee with an annual income of $35,000. If that employee elects to pre-tax $2,000 of qualified insurance benefits, the IRS will consider the actual taxable income to be only $33,000 ($35,000 less the $2,000 paid for insurance premiums). The employer also only reports $33,000 in income for this employee, which means a lower payroll tax liability.

Plan Sponsor Responsibility

The plan sponsor is solely responsible for the day-to-day administration of a POP plan. In addition, given that POP plans are generally self-administering, AmeriFlex has no control over day-to-day administration and can therefore simply provide general guidance for POP plan administration. This manual is not intended as legal or other professional advice, and provided examples are for informational purposes only and not intended to reflect any particular real-world situation. The federal tax code and the regulations mentioned in the text of this document are subject to change at any time. Employers are strongly urged to consult their own professional advisors for more information specific to their individual situations.
How to Install Your POP Plan

The IRS imposes certain requirements on employees and employers who want to enjoy these pre-tax benefits. These requirements fall into two general categories: 1) establishing the plan and 2) administering the plan.

PART I: ESTABLISHING YOUR PLAN

The most important requirement for a compliant POP plan is the development and adoption of a written plan document that lays out the rules of the plan in specific detail.

IRS regulations are very clear that a written plan document is required for the proper establishment of a POP plan. The failure to have a written plan document can result in the legal disqualification of a POP plan and significant tax penalties for the employer and participating employees.

What is a POP plan document? You should think of a POP plan document as the official rulebook for the plan. It specifies the guidelines for the plan: what benefits are offered under the plan, how employees can elect those benefits, how the terms of the plan can be changed, etc. Once the plan document is adopted, employers and employees alike must follow its terms to the letter.

Step One: Design Your POP Plan

A POP plan is an employer-sponsored benefit plan, meaning that the employer makes the rules (within IRS guidelines, of course). Before establishing the plan, the employer must make certain decisions about the plan, such as:

- What will be the “plan year”? (a)
- What benefits should be offered under the plan? (b)
- What employees will be eligible to participate in the plan? (c)
- How will contributions be made under the plan? (d)
- What will the plan name and plan number be? (e)

(a) Plan Year: A POP plan must run on a “plan year,” meaning participants elect benefits for a 12-month period of time. Most POP plans run on a calendar year basis, but that is not a requirement. In fact, employers whose annual insurance contracts are not set on a calendar year often choose to run their POP plan consistent with those contracts. The decision is completely up to the employer.

It is also possible to establish a “short plan year,” which is a period of time less than twelve months. This is often done when an employer wants to establish a POP plan as soon as possible but the insurance contract doesn’t renew for a number of months.

Important Note: You cannot establish a retroactive POP plan. POP plans must be established on a go-forward basis. Therefore, you cannot start a POP plan year on a date that has already occurred. If, for instance, you decide to adopt the plan on March 3, 2009, you cannot have your POP plan begin on March 1, 2009. The beginning date must be at some point on or after the actual adoption of the plan.
b) Benefits: The employer should decide which benefits it wants to offer under its POP plan. Health benefits (major medical, dental, and vision insurance) are the most common choices, but, as stated above, it is possible to offer a number of other insurance benefits under a POP plan.

c) Employee Eligibility: The employer must decide what eligibility requirements to place on its employees. Does the employer want to exclude certain categories of employees from the plan? Should the plan be made available to full-time employees only? Should there be a waiting period for employees before entering the plan?

Keep in mind that while the employer has discretion with regard to employee eligibility rules for POP plans, these rules are also subject to IRS-enforced nondiscrimination rules, which prevent employers from disproportionately favoring some employees (e.g., highly compensated participants or HCPs) over others. The general rule is that the more favorable and equal your plan’s eligibility rules are for all employees regardless of income or position, the more likely your plan will pass discriminatory muster. For more information about nondiscrimination rules for POP plans, see Appendix A of this guide.

Employers should also be aware that self-employed persons cannot participate in POP plans. Self-employed, for these purposes, includes sole proprietors, partners in partnerships, members of LLCs, and more-than-2% shareholders of S-corporations. Furthermore, neither the spouse of more-than-2% shareholders, nor the children, parents, or grandparents of more-than-2% shareholders can participate in an S-corporation’s cafeteria plan.

d) Contributions: The employer must decide whether it wants to allow for both elective contributions as well as non-elective contributions under its POP plan. Elective contributions are standard employee salary reductions: employees elect to make these contributions. Non-elective contributions are general contributions made by the employer that employees can choose to use to pay for benefits (these are sometimes called flex credits or flex dollars). As with the plan eligibility rules, these non-elective contributions must be nondiscriminatory in nature.

e) General Plan Information: The employer will need to name its POP plan. This can be as simple as “The XYZ Company POP Plan” or something along these lines. The employer must also establish a plan number for its plan. This can be any three-digit number between 501 and 999 (501 is the most common for first-time plans), but it cannot be the same number as that of any of the employer’s other benefit plans.

The employer must also name the plan’s administrator (usually the employer itself) and provide the employer’s tax identification number (the EIN) and the agent of process for any legal actions taken against the plan.

Step Two: Creating Your POP Plan

Once the plan has been designed, your benefits agent or consultant will create your plan document, summary plan description (SPD), and plan adoption agreement using the ePOP® document engine. The completed documents will then be delivered to you for your review and adoption.

Step Three: Review, Finalize, and Adopt Your Plan Document

It is important that the employer review the plan document for accuracy before adopting the plan because the plan document is a legal instrument that obligates the employer to follow its rules in
the administration of its plan. The employer should also review the accompanying SPD for accuracy, since this is the document that will be distributed to employees to explain the details of the POP plan. If the employer is satisfied with both the plan document and the summary plan description, it should “adopt” the POP plan with the plan adoption agreement provided by ePOPsm.

PART II: ADMINISTERING YOUR PLAN

Once you have adopted your plan document, you are ready to administer your POP plan. POP plan administration is very straightforward as long as you understand the annual POP administration cycle.

Before the Plan Year Begins: The most vital POP plan administration activities occur before the POP plan year begins.

Open Enrollment

The open enrollment period is the most important event before a POP plan year begins. The open enrollment period is the time (usually anywhere from a week to a month) during which employees enroll in the employer’s benefit plans for the coming plan year. With a POP plan in place, the employees will also be electing whether or not they want to pay for their share of those benefits on a pre-tax basis. The most important thing for employers and employees to understand about these elections is that they are irrevocable: whatever choice is made must stay the same throughout the plan year (subject to certain exceptions, described in the section entitled “During the Plan Year”).

Important Note: Choosing not to elect any benefits during the open enrollment period is itself an election choice that is subject to the irrevocable election rule.

Employees can enroll in a variety of ways. Most commonly, employees make their elections on a paper form or through electronic elections such as agent-assisted electronic enrollments or via an online enrollment process. It is very important that employees make their elections before the plan year begins. Generally speaking, employees cannot make retroactive elections.

For administrative convenience, open enrollment periods usually conclude at least a month before a plan year begins (therefore, a POP plan with a calendar year plan year might have its open enrollment period in November of the preceding year). This provides ample time for the employer to process the elections, share the enrollment data with its insurance carriers, and prepare the payroll processing for the plan year. Contract payroll processors are usually very familiar with POP plans and will assist you with the payroll. If you process your payroll in-house, your payroll processing software should guide you through the steps.

Discrimination Testing

The close of the open enrollment period is always a good time to conduct your POP discrimination testing in the ePOPsm discrimination-testing portal. By doing this, any adjustments that need to be made can be completed before the plan year begins.

Distribution of SPDs

The employer should also distribute copies of the POP plan SPD to all plan participants before the beginning of the plan year. This is traditionally done in paper form, but electronic distribution is also valid.
During the Plan Year: Once the information gathered from the open enrollment period has been properly processed, POP plans are generally self-administering, consisting of two periodic activities: 1) the recording of payroll deductions according to the elections of the plan participants and 2) the timely payments of premiums to the insurance carriers. Unlike medical FSAs or dependent care FSAs, there are no claims to process with POP plans. In fact, you never handle or otherwise process participant funds at all: reduced salaries are reflected through payroll and insurance premiums are paid out of the employer’s general fund.

Mid-Year Enrollment

Assuming the employer allows for mid-year enrollment, employees who meet the POP plan eligibility requirements during the plan year can be allowed to join the plan at mid-year under the same terms as other eligible employees. The terms of election detailed in the plan document for such mid-year enrollees must be followed.

Changing Elections Mid-Year

The most significant mid-year issue an employer may face is the application of the irrevocable election rule. As discussed above (in the section entitled “Before the Plan Year Begins”), employee salary reduction elections made during the open enrollment period under POP plans cannot be changed during the plan year. This is one of the trade-offs the IRS requires in return for the significant tax savings a POP plan offers.

The irrevocable election rule is often misunderstood and can be a source of worry for many employees who fear that they won’t be able to change their elections under certain unforeseen circumstances. The IRS and other laws, however, allow for a number of exceptions to the irrevocable election rule, making its application much more fair and reasonable to POP plan participants.

Exceptions to the Irrevocable Election Rule for POP Plans

1. Changes in status such as:
   • a change in legal marital status
   • a change in the number of dependents
   • a change in employment status of employee, spouse, or dependent(s) affecting benefit eligibility under a cafeteria plan
   • a change causing the loss of eligibility for a dependent
   • a change in the employee’s, spouse’s, or dependent’s place of residence

2. Leaves of absence (all types, including FMLA and non-FMLA leaves)
   • Important Note: Employees taking a leave under the Family and Medical Leave Act (FMLA) have the right to maintain their health coverage throughout that leave. This can be paid for in one of three ways: 1) the premiums are paid on a pre-tax basis before the leave (this cannot be the only option made available), 2) the premiums are paid on a pre-tax basis after the leave, or 3) the premiums are paid on an after-tax basis during the leave.

3. Significant change in cost of insurance benefits
4. Significant change in coverage provided or benefits offered, such as:
   • curtailment of insurance coverage
   • addition or significant improvement in benefits offered under the POP plan
   • loss of group health coverage offered through a government or educational institution
   • change in election under another employer’s plan (this resolves the possible “election lock”
     problem faced by spouses whose employers have different plan years)

5. Entitlement (or loss of entitlement) to Medicare or Medicaid

6. Certain domestic relations judgments, judicial decrees, or orders mandating coverage (e.g., an order requiring that a divorced parent provides health coverage to a child)

7. COBRA qualifying events

8. HIPAA Special Enrollment Rights arising upon the loss of other health coverage or the acquisition of a new dependent by marriage, birth, adoption, or placement for adoption
   • Important Note: Unlike many of the listed exceptions to the irrevocability rule, these special enrollment rights are not optional for employers. Furthermore, in a major departure from the usual POP plan rules, employees may make retroactive elections due to the acquisition of a new dependent by birth, adoption, or placement for adoption (but not by marriage).

9. Children’s Health Insurance Program (CHIP) Special Enrollment Rights arising for employees and dependents who are “eligible but not enrolled for coverage” under a group health plan and
   1) have had Medicaid or CHIP coverage terminated or 2) have become eligible for a Medicaid or CHIP group health plan subsidy.

It is important to understand that these exceptions are the only exceptions that are explicitly allowed. While some of the exceptions (most notably the “significant cost change” exception) can be vague, the IRS does not allow for the mid-year changing of elections that do not fall under one of these exceptions. The most common attempt to circumvent the irrevocable election rule occurs when an employee encounters a previously unforeseen financial hardship. Unless such hardship is due to an event that is clearly related to an event in the exceptions list (for example, a divorce, the birth or adoption of a baby, a change in coverage, etc.), it is not an acceptable reason to change an election plan in mid-year.

Furthermore, any changes to elections made pursuant to any of these exceptions must be consistent with that exception. An event giving rise to a mid-year election change does not necessarily allow for any kind of election change—it must be a change that is consistent with the event. For example, the birth of a child would allow an employee with employee-plus-spouse health insurance coverage to change that coverage to family coverage. It would not enable the employee to change the coverage to employee-only coverage.

Employers should also be aware that in cases of short-term terminations (i.e., terminations lasting 30 days or less), the employee’s election cannot be changed on the basis of the termination and rehire.

**Open Enrollment for the Following Plan Year**

Since plan years run back to back, the open enrollment period for one plan year will take place during the preceding plan year. Follow the same procedures described in the “Open Enrollment Period” subsection of the above section entitled “Before the Plan Year Begins.”
Discrimination Testing

At least twice during the plan year (more specifically, about two-thirds of the way through the plan year and on the last day of the plan year), and more often if plan participation and participant elections dramatically fluctuate over the course of the plan year, the employer should conduct discrimination testing for its POP plan through the ePOPsm discrimination-testing portal.

After the Plan Year Concludes: If your POP plan began the plan year with 100 or more participants, you may have to file Form 5500, a federal government employee benefits reporting form. Form 5500 must be filed by the last day of the seventh month after the conclusion of the plan year unless a time extension is granted. For more information about Form 5500 requirements, please consult the Employee Benefits Security Administration’s website at http://www.dol.gov/ebsa/5500main.html.

With the exception of Form 5500, there are no other reporting requirements for POP plans, including W-2 reporting requirements.
**Discrimination Considerations**

To enjoy the tax benefits of a POP plan, the IRS Code requires that the plan is not discriminatory. Generally speaking, this means that a POP plan cannot favor “highly compensated participants” and/or “key employees.”

A “highly compensated participant” is a participant who:
- is an officer,
- owns more than five percent of the voting stock or value of all classes of stock of the employer,
- is highly compensated (as defined each year by the IRS), and/or
- is a spouse or dependent of any of the foregoing.

A “key employee” is an employee who is:
- an officer of the employer with annual compensation in excess of a specified dollar threshold (as defined each year by the IRS),
- a more-than-5% owner of the employer, or
- a more-than-1% owner of the employer with annual compensation in excess of $150,000 (not indexed annually).

There are three tests that POP plans must pass in order to be deemed nondiscriminatory:
- The Eligibility Test determines whether enough non-highly compensated individuals are eligible to benefit from the POP plan.
- The Contributions and Benefits Test determines whether employer contributions and benefits are offered on a nondiscriminatory basis under the plan.
- The Key Employee Concentration Test determines whether key employees receive no more than 25% of the total dollar amount of benefits (generally calculated as “employee-pre-tax-contributions-plus-employer contributions”) under the plan.

The Key Employee Concentration Test is based on a mathematical calculation alone. The other tests, however, can be quite complicated. The good news is that if a plan sponsor designs its POP plan on an even keel with regard to HCPs and non-HCPs by casting the overall benefits “net” as widely and as equitably as possible, the plans should easily pass both the Eligibility Test and the Contributions and Benefits Test.

ePOPsm offers a discrimination-testing portal through which ePOPsm clients may conduct these tests at their convenience. This service is offered on a complimentary basis and can be used at any time.
CUSTOMER SERVICE TOLL-FREE PHONE: 888.868.3539 (option 2, option 3, 8:30 a.m. to 5:30 p.m. E.S.T.)

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