National Association of Insurance and Financial Advisors

TESTIMONY
OF
NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS
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HOUSE SMALL BUSINESS COMMITTEE
SUBCOMMITTEE ON ECONOMIC GROWTH, TAX, AND CAPITAL ACCESS

"Cafeteria Plans: A menu of Non-Options for Small Business Owners"

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Good morning Chairman Brat, Ranking Member Evans, and Members of the Subcommittee. My name is Matthew Tassey, and I am testifying today on behalf of the National Association of Insurance and Financial Advisors ("NAIFA") for whom I currently am serving as Treasurer. Thank you for giving us this opportunity to share our perspective on cafeteria plans.

Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is one of the nation's oldest and largest associations representing the interests of insurance professionals from every Congressional district in the United States. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members. Most of our members work with small businesses and their owners on a wide variety of security and financial needs confronting the businesses, their owners, and employees. As a result, most NAIFA members routinely talk to their clients about cafeteria plans and the benefits they offer the business, the workers, and the owners.

I am a principal of Scribner Insurance and Burwell & Burwell, an employee benefits broker in Portland, Maine. I work with small and some large employer groups in all aspects of benefit plans and design.

On behalf of my colleagues at NAIFA and most importantly, on behalf of our small business owner clients, thank you for your interest in allowing them to participate in a cafeteria plan.

Background

A cafeteria plan is a separate written plan maintained by an employer for employees that meets the specific requirements of and regulations of Section 125 of the Internal Revenue Code. It allows eligible workers to choose from among a variety of qualified benefits, or instead receive taxable cash. Usually, if a worker chooses one or more of the benefits offered in the plan, the benefits are paid for by way of a pre-tax salary reduction amount.

A qualified benefit is a benefit that does not defer compensation and is excludable from an employee's gross income. Qualified benefits include:

- Accident and health benefits (but not Archer medical savings accounts or long-term care insurance)
- Adoption assistance
- Dependent care assistance
- Group-term life insurance coverage
- Health savings accounts, including distributions to pay long-term care services

Section 125 requires the plan to specifically describe all benefits, establish rules for eligibility and elections, and to be offered on a nondiscriminatory basis. To ensure compliance, the Internal Revenue Code sets forth testing requirements that must be satisfied. These testing requirements are in place to make certain that Cafeteria Plan benefits are available to all eligible employees under the same terms, and that the Plan does not favor highly compensated employees, officers, and owners.

Premium Only Plan (POP)

Employers may deduct employees' portion of the company-sponsored insurance premium directly from employees' paychecks before taxes are deducted.

Flexible Spending Account (FSA)

In an FSA, employees may set aside on a pre-tax basis a pre-established amount of money per plan year. Employees can use the funds in the FSA to pay for eligible medical, dependent care, or transportation expenses.

Improve Cafeteria Plans by Making Pass-Through Business Owners Eligible to Participate, and Allowing Cafeteria Plans to Offer Qualified Long-Term Care Insurance

There are two elements of the cafeteria plan rules that could be substantially improved: first, under current law, owners of pass-through businesses—Subchapter S corporations, partnerships, LLCs, and sole proprietorships—may not participate in a cafeteria plan. This should be changed. Second, a security benefit of growing importance to America's workers, long-term care insurance, is not a permissible benefit in a cafeteria plan. This, too, should be corrected.

NAIFA strongly encourages Congress to correct these two issues, by making pass-through business owners eligible to participate in a cafeteria plan and to allow inclusion of employer-sponsored qualified long-term care insurance in cafeteria plans.

Cafeteria Plan Benefits Outweigh Disadvantages

Since their introduction in the early 1980's, cafeteria plans have become a popular method for employers to provide health and other benefits in a way that results in employee tailored benefits.

Not every employee has the same security needs as their co-workers. A family with young children will value a cafeteria plan's dependent care benefit, while a single worker who has no children will find that benefit of no real value. Some workers get their health insurance through their spouse's plan, making their own employer's offer of health insurance less valuable. Some workers find the flexibility of an FSA valuable in meeting their projected health expenses that are not covered by insurance, while others would prefer a different benefit or taxable cash compensation. Cafeteria plans allow different workers to accommodate their unique situations in choosing the benefits that are most valuable to them.

The uniform reimbursement aspect of section 125 allows an employee to be reimbursed for qualified medical expenses that exceed their contributions to date. This rule can put the employer at risk if an employee in a health FSA quits before contributing the full amount for which he has been reimbursed, and there is a modest employer cost to installing and maintaining a cafeteria plan.

Under the "use it or lose it" rule, an employee must forfeit unused FSA contributions at the end of the plan year. However, with appropriate planning and good communication, the effect of any disadvantages can be greatly minimized.

The advantages of establishing a cafeteria plan for both employers and employees significantly outweigh any perceived disadvantages. Employees can receive the benefits they want while at the same time helping to control benefit costs.

Make Pass-Through Business Owners Eligible to Participate in Cafeteria Plans

Small employers are often organized as pass-through businesses. The Small Business Administration 2016 profile indicates small businesses employed 56.8 million people or 48 percent of the total U.S. workforce.

While not all pass-through businesses are small, most are. And most employ workers. Business owners, or in the case of the Subchapter S business, its partners-shareholders ultimately pay the bill for the workers' salaries, and for all the employee benefits that their businesses offer. It is unfair, to say the least, that these business owners cannot participate in a benefits plan as valuable as the cafeteria plan. These business owners have unique security and benefits needs just like their employees. The discrimination rules contained in IRC Section 125 would prevent a pass-through business owner from designing a plan that primarily benefits him or herself.

Cafeteria plan rules require that at least 75 percent of the plan's benefits accrue to the plan sponsor's non-highly-compensated/non-key employees.

Lincolnville Telephone is a family owned company providing phone/internet coverage in mid-coast Maine with 40 employees. There are five family members who are excluded from participating in the Section 125 program. They offer it anyway to provide this benefit to their employees and their families to help reduce the costs for themselves and their dependents. They also use the FSA opportunity to reduce out of pocket costs.

RHR Smith & Co, a 20 person accounting/audit firm in Buxton, Maine does the same thing in spite of the three shareholders being excluded.

The inability of the small business owner to participate in a cafeteria plan acts as a disincentive to design, implement, administer and pay for a cafeteria plan—which, according to the rules of section 125, must be in writing and permanent in nature. Making small business owners eligible to participate in cafeteria plans would likely encourage more of my small business clients interested in making these flexible plans available to their workers. That, in turn, would increase the financial security of their employees and themselves.

We insure about 60 smaller companies who do not participate because they are structured as partnerships Sub-S corporations, and they may only have part-time employees and are denied participation. As the "oldest state in the country" healthcare can often cost a family $1800-$2200/monthly and these small business owners are unable to take advantage of this very important benefit.

Make Long-Term Care Insurance a Permissible Cafeteria Plan Benefit

Qualified long-term care insurance is, for tax purposes, treated as health insurance. Because it is also considered akin to deferred compensation, this increasingly valuable form of insurance is not permitted to be included in the menu of cafeteria plan offerings.

With our aging population, the pressure on Medicaid, and an increasing sense of responsibility for planning for the expenses of "living too long," the need for long-term care insurance is acute and growing. The ability to provide for that need through the convenience of an employer-sponsored cafeteria plan would likely increase the number of people who protect themselves against the risk of expensive long-term care via qualified long-term care insurance.

This would contribute to workers' peace of mind, and quality of work-life balance. It would ease some of the pressure on Medicaid and family resources as loved ones incur the long-term care expenses. And, qualified long-term care insurance is subject to protective rules, both on the quality of the policies and on the cost to taxpayers of making those policies available—as is the case for long-term care insurance purchased outside of a cafeteria plan.

Summary

Cafeteria plans allow employers to offer flexible benefits to their workers, at a reasonable cost to both the workers and the employers. The flexibility of being able to let workers choose benefits best suited to their unique circumstances is often the most important reason for an employer to establish and maintain this type of benefits plan.

It is unfair to pass-through business owners to exclude them from eligibility to participate in cafeteria plans. And, it may discourage these owners from offering—and paying for—cafeteria plan benefits to those who work for them.

Long-term care insurance is more like health insurance than like deferred compensation. It is a security product that should be permitted as a cafeteria plan option.

Thank you again, Mr. Chairman and members of the Subcommittee, for this opportunity to provide you with NAIFA's views on this important topic. I'd be pleased to answer any questions you may have.