

# Cafeteria Plan Nondiscrimination Rules

Cafeteria plans are generally subject to the nondiscrimination requirements of Internal Revenue Code [section 125](#). To satisfy the section 125 nondiscrimination requirements, a plan generally must satisfy three tests:

- **Eligibility Test:** The plan may not discriminate in favor of **highly compensated individuals** as to eligibility to participate; and
- **Benefits and Contributions Test:** The plan may not discriminate in favor of **highly compensated participants** as to benefits and contributions; and
- **Key Employee Concentration Test:** The nontaxable benefits provided to **key employees** may not exceed **25%** of the nontaxable benefits provided for all employees under the cafeteria plan.

**Safe harbors** for satisfying these nondiscrimination tests exist for [simple cafeteria plans](#) and premium-only plans (POPs) meeting specific requirements. For more information on the safe harbor for POPs, read the [2007 proposed cafeteria plan regulations](#), **which employers may rely on for guidance pending the issuance of final regulations**.

## Highly Compensated Individuals

For purposes of section 125, the term "highly compensated individual" means an individual who is:

- An officer;
- A shareholder owning **more than 5%** of the voting power or value of all classes of the employer's stock;
- Highly compensated (generally **\$125,000** in compensation and, if elected by the employer, in the top-paid 20% of employees); or
- A spouse or dependent of an individual described in the three bullet points above.

## Highly Compensated Participants

For purposes of section 125, the term "highly compensated participant" means a highly compensated individual (see above) who is eligible to participate in the cafeteria plan.

## Key Employees

For purposes of section 125, a key employee is generally an employee who is **either** of the following:

- An officer having annual pay of **more than \$180,000**; or
- An employee who is either of the following:
  - A **5% owner** of the business; or
  - A **1% owner** of the business whose annual pay is **more than \$150,000**.

Due to the complexity of testing plans for compliance with the section 125 nondiscrimination rules, any employer that is considering offering health benefits to only certain classes of employees should seek the advice of a knowledgeable benefits attorney.

**Additional nondiscrimination requirements apply to benefit offerings.** [Click here](#) for more information.