Important Information Regarding Your Health FSA/Dependent Care FSA

What is non-discrimination testing?

Non-discrimination testing rules were created by the IRS and are generally designed to prevent plans from discriminating in favor of individuals who are either highly compensated or otherwise key to the business. Testing shows whether or not your tax-advantaged plans are discriminating in favor of highly compensated employees or key employees.

What plans require non-discrimination testing?

The IRS requires non-discrimination testing for employers who offer plans governed by **Section 125**, which includes a **flexible spending account** (FSA).

Why does non-discrimination testing matter?

The IRS mandates testing to make sure there isn't discrimination between highly compensated employees (HCEs)/key employees and other employees at a company. To meet IRS requirements, the test results need to demonstrate fairness in benefit plans among all levels of employees at a business. Failure to comply puts employers and their employees at risk of having to pay taxes on the benefits and IRS penalties.

How often should non-discrimination testing be done and when should you test?

NDT (Nondiscrimination testing) should be performed by the last day of the current plan year and include all employees who were employed on any day during the plan year. It's also recommended that employers test once early or in the middle of the plan year. This mid-year testing helps determine if additional steps should be taken to ensure the employer passes the test by the end of the plan year. Engage PEO will have a Midyear testing on FSA Health and Dependent Care elections.

What tests are available?

Health FSA and Dependent Care FSA

A benefits plan will be considered discriminatory and fail to be in compliance if:

- Not enough non-HCEs **(Highly Compensated Employee**) are eligible for a plan.
- The HCEs or key employees are able to get more benefits than other employees.
- The HCEs or key employees take more benefits under the plan than other employees.

For a 2024 plan year, an HCE for Dependent Care is an employee who:

- earned more than $150,000 in the previous year (2023)
- is an officer.

- is a shareholder owning more than 5%
- is a spouse or dependent of any of the bullets above?

A Highly compensated individual for Health FSA is still going to be the five most highly paid officers, more-than-10% shareholders, and all individuals who are within the highest paid 25% of all non-excludable employees.

What is the HCE for FSA testing?

Highly Compensated Individual (HCI): (To be used for the Cafeteria Plan Eligibility Test)

- An Officer during preceding plan year (or current plan year in the case of the first year of employment)
- A more-than 5% owner of the employer during the preceding or current plan year
- An employee with annual compensation more than the "Highly Compensated Employee" specified dollar threshold for the preceding year (or current plan year in the case of the first year of employment)
    - $155,000 in 2024 and $150,000 in 2023
- Spouse or dependent of any of the above

What is Required?

The IRS requires that these tests are performed on an annual basis, once the plan year is complete. Unlike other benefits testing, the Section 125 and FSA tests are not filed with any government agency. They are to be performed and kept on file to produce in the event of a Plan audit.

If testing is performed and **the Plan fails, the usual course of action is to include the effected benefits as taxable income for Key and Highly Compensated Employees**.