



SBCA SUPPORTS MAKING CAFETERIA PLANS AVAILABLE TO SMALL BUSINESS OWNERS AND THE SELF-EMPLOYED

The Small Business Council of America (SBCA) urges Congress to pass the SIMPLE Cafeteria Plan Act of 2007 – S. 555. Currently there are 46 million uninsured American citizens in this country; 60% of these uninsured Americans either work for small businesses or are the family members of employees of small businesses. The SIMPLE Cafeteria Plan provides an incentive for small business owners to sponsor cafeteria plans, thereby making it easier for the employees of these businesses to be covered by health insurance and other valuable employee benefits just as it is for their counterparts who work for larger businesses. SBCA agrees with Senator Snowe who believes that “Establishing a SIMPLE Cafeteria Plan for small businesses will help them offer the same health insurance and savings options currently available to employees of large companies and government agencies.”

Currently, cafeteria plans (also known as IRC Section 125 plans) allow participants to pay for health insurance coverage, dependent care costs (IRC Section 129) and out-of-pocket medical expenses (IRC Section 105) on a pre-tax basis. Cafeteria plans allow employees to obtain and pay for, on a pre-tax basis, employee benefits, such as deductibles, co-pays, drugs, braces, eyeglasses and other health care expenses, as well as dependent care, adoption expenses, and group term life insurance. These important tax breaks currently allow many Americans, who would not otherwise have the opportunity, to obtain health coverage. The tax savings can be as much as 30 percent. An example of saving on a pre-tax basis is the dramatic success of employees saving for their retirement through 401(k) plans.

While employees of big businesses, mid-size employers, non-profits, schools, universities and the federal government appreciate the valuable benefits provided by cafeteria plans, small business owners are presently precluded from participating in cafeteria plans.

Under current law, cafeteria plans can be utilized by common-law employees but not by:

- Sole proprietors.
- Partners in a partnership.
- S-corporation 2% or more shareholders (and by attribution, their family members).
- Members in a limited liability company.

As a result, without the small business owners able to participate in cafeteria plans, employees of small businesses are seldom offered this valuable benefit.

The root of the problem is that small business owners are at a double disadvantage in offering health care and other employee benefits for their employees. As mentioned above, IRC Section 125 does not include self-employed individuals in its definition of “employee.” As a result, sole proprietors, partners, shareholders owning 2% or more in S-corporations, and members of limited liability companies are all unable to participate in cafeteria plans. This creates a significant disincentive for small business owners to provide cafeteria plans for their employees. The employees of small businesses who do provide healthcare benefits face higher insurance premiums because these businesses lack the bargaining power of larger businesses. So not only are employees of large businesses three times more likely to have health insurance than employees of small businesses, but they are also likely to pay a lot less for that insurance.

By providing a safe harbor, the SIMPLE Cafeteria Plan would help small businesses satisfy the nondiscrimination cafeteria plan rules. These tests are difficult for small businesses to satisfy due to their size. The SIMPLE Cafeteria Plan would provide a safe harbor for satisfying the nondiscrimination rules, in exchange for making a required annual contribution of 2 percent or a matching contribution of 3 percent to their employees’ accounts, for health insurance and other employee benefits.

Other benefits of Congress approving the SIMPLE Cafeteria Plan include: the carryover of unused flexible spending account funds, simplifying the administration of and increasing the amounts contributed to dependent care accounts; allowing cafeteria plans to provide for long-term care insurance; and eliminating the “use it or lose it” rule which punishes workers’ good health by forfeiting a portion of their salary to their employer because they did not spend all of their cafeteria plan dollars on health care.

The SIMPLE Cafeteria Plan is modeled after the successful and effective 1996 SIMPLE Pension Plan. That plan has already shown that it provides sufficient benefits for the owners and non-owner employees to persuade the owners to make the additional contributions that would be required. Additionally, with their acceptance of the SIMPLE Pension Plan, small business owners have demonstrated that they are willing to absorb some additional cost for employees in the way of required contributions in exchange for relief from complex administration and discrimination tests.

Cafeteria plans should be able to provide employees of small businesses with long term care insurance. If allowed to purchase long term care insurance on a pre-tax basis and by payroll deduction, it is far more likely that employees will elect to be covered by long term care. Encouraging citizens to finance their own long term care is desirable as it will help to shift the burden away from the government in addressing the long term care needs of the baby boomer generation. The entire country wins when Congress can incentivize individuals to purchase long term care insurance on their own.

[SBCA believes that by passing S. 555, Congress will again make strides in promoting and increasing health care coverage for the working American without creating new entitlements.](#) It will allow small business employees to join their counterparts in mid-size and large businesses in saving for health care and other employee benefits in a tax

advantaged manner. Furthermore, it makes sense for all employees regardless of the size of the entity they work for to be able to have access to the same benefits under the tax code. S. 555 also works towards the greater goal of simplifying the tax code, which Treasury has determined will assist in closing the tax gap – the gap between what the Nation collects in taxes and what it should collect.

Example of SIMPLE Cafeteria Plan

Innovative Co., an LLC, has 5 owners and 15 employees. It has been in business for four years and wants to provide its employees with some benefits. It has some younger employees with young children and some older employees, some of whom have infirm parents. Some of its employees have come from the federal government or larger companies and have asked for the types of benefits previously available to them. Innovative Co. decides to consult with its employee benefits advisor to find out what is the best way to tailor a benefits program for its employees.

Before S. 555:

Innovative Co. would offer some form of health insurance – the employees would have to pay for their portion of the premium on an after-tax basis. The company might offer a group term insurance benefit – all the employees would be covered whether they needed insurance or not. If Innovative Co. were to inquire about offering a cafeteria (a.k.a. Section 125 plan) similar to that offered by the federal government or larger companies, the advisor would inform them that none of the owners could be covered, so in all likelihood the company would not be interested in the plan.

After S. 555:

Innovative Co. would offer a SIMPLE cafeteria plan. Employees could pay for their portion of health insurance on a pre-tax basis. Employees with young children could opt for the dependent care coverage if they chose to do so by having their payroll reduced to pay these expenses on a pre-tax basis. This benefit is also available to older employees who have parents who are infirm or other dependents who need care. Employees could choose to reduce their paycheck and put that money into a flexible health care spending account where it could be used to pay for medical expenses not covered by insurance, such as eye glasses or braces. Alternatively, employees could opt for dental insurance. They could also choose to increase the amount of life insurance available to them or even select long term care insurance, if needed. Each employee is able to tailor his/her own benefits package to suit his/her own needs. The result is that the employees have a more active role in selecting their benefits and, by joining Innovative Co., are not robbed of the opportunity to enjoy valuable benefits routinely available with larger companies and the federal government.

For more information please contact Paula A. Calimafde, Chair of the SBCA, at (301) 951-9325 or calimafd@paleyrothman.com.