Nondiscrimination in HRA and Cafeteria plans
ftwilliam.com webinar Q&As
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There were a large number of questions received during the webinar. The questions are arranged according to the type of nondiscrimination rules being addressed (HRA/FSA or cafeteria plans) - the first section addresses questions that apply to both nondiscrimination rules. The end of the Q&As address questions that are not directly related to 105/125 nondiscrimination testing. Similar questions are grouped together as much as possible.

"Take home messages" from the training/Q&As:

- *Testing should be done as early in the year as possible.*
- *Smaller plans tend to create the most problems and plan sponsor may be best served to exclude highly compensated employees from the plan (or at least stick to simple plan designs with fewer options)*
- *Complicated plans with different entry dates and different benefits for different employees will also create problems. Keep it simple.*

Questions applicable to both HRA and Cafeteria plan nondiscrimination

Q1: Does the term "benefit" mean actually using the benefit, or just that it is available? Can you discuss what it is to "benefit" especially for a health FSA? I may have missed it; how do you define "benefits" for the benefits test; the total contribution amount? Please define benefiting for Section 105 and section 125 purposes. In performing the Eligibility test, which employees are considered benefiting?

A1: I obviously should have been clearer on this point as this was the most popular question I received during the webinar. To benefit under Code section 105 means to receive a reimbursement (this applies equally to HRAs and FSAs).

To "benefit" under code section 125 will depend on the type of test:

> *Key employee test*: A benefit is a nontaxable, qualified benefit (contribution to an FSA, HSA contribution, health insurance premiums pre-tax, etc.).

Eligibility test: It is reasonable to assume that to be eligible for the plan is generally the same as benefiting under the plan (the proposed regulations do not actually define the term "benefiting"). Note: other interpretations may also be reasonable - I am just suggesting one here.

Benefits test: This test really looks at all possible benefits under the plan (taxable and non-taxable). Benefits must be uniformly available (employer contributions and the ability by employees to make contributions). In addition, the actual election of qualified benefits must not be disproportionate and utilization of employer contributions cannot be disproportionate.

Q2: Are the excludible employees only excludable IF they are excluded from participation? or can you exclude them regardless of whether they are in the plan? Do these excludible employees get counted in the Benefits % test?

A2: In general, the excludible employees are excludible regardless of whether they are in the plan for purposes of eligibility testing. (Section 105 nondiscrimination utilizes a test of whether 70% of nonexcludible employees benefit as part of the eligibility test.)

There are, however, exceptions for Cafeteria plan nondiscrimination eligibility testing:

Under cafeteria plan nondiscrimination, employees with less than 3 years of service may only be excluded if all employees with less than 3 years of service are excluded from the plan.

Another testing alternative I did not discuss during the training is the option to permissively disaggregate employees with less than 3 years of service and test those with less than three years of service separately from those with three or more years of service as separate plans (see 1.125-7(g)).

For both 105 and 125 nondiscrimination, only plan participants are considered for the purposes of the benefits test.

Q3: Can you confirm the age for excluded employees? Is it 21 or 25?

A3: 25

Q4: Does 414(b)(c) have an effect on eligibility. Also, does it have an affect if there is an FSO and an Org A issue? Example Law firm has three principals 2 principals have 45% of the stock each. Their wives own an advertising agency 50%-50%. Law firm uses the services of the advertising agency causing commissions to the wives of $30,000 each. The advertising agency has a HRA for $6,000 each and a §125 for 6,000 each no other employees in

the advertising agency however the law firm has 20 employees and no benefits, not even a 401(k). Does the husband wife have a §414 (b) or (c) or an affiliated service problem?

A4: 414(b), (c), (m) and (o) will have an effect on the eligibility tests for cafeteria plans and section 105 plans. All employees treated as employed by a single employer under 414 will be treated as a single employer for nondiscrimination testing.

The second part of the question will depend on an analysis of 414 and is ***highly*** fact specific - (could depend on whether the facts take place in a community property state, whether each participates in management of the different entities, underlying buy/sell agreements, etc.). I would strongly recommend requiring an employer to tell you if they are part of a controlled group (in writing - likely an opinion from a CPA and/or attorney) and not try to determine this on your own.

If the two companies are considered a single employer for nondiscrimination testing, the situation would likely create nondiscrimination eligibility problem - although it is possible to pass the classification test under 105 and the plan could pass the ratio percentage test if the law firm consists mostly of HCEs. Again, the nondiscrimination testing outcomes are highly fact specific.

Q5: Did I hear you say that if the plan passes the Eligibility Test, it does Not need to continue with the Contributions and Benefits Test?

A5: No. The eligibility and benefits tests both must be passed to meet nondiscrimination. The only exception is that premium only 125 plans do not need to meet the benefits test.

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Q6: If an employer fails the Eligibility HCE nondiscrim. test, what is the correction or penalty? Especially if not tested until after plan year end? When the nondiscrim. testing is done, it is generally done after the plan year end and after W-2's are issued. So what is the proper reporting for the taxable wages due to failed nondiscrim. testing? Should W-2's be revised? or can 1099-s be issued?

A6: I would strongly recommend testing cafeteria plans and HRA plans throughout the year to prevent this problem. Cafeteria plans can generally be tested before the plan year since most of the elections for the plan year should be in place at that time (of course, terminations, new hires and changes in employee status will occur - but you will also be better informed of whether one of those changes could throw off the plan). HRA plans can also be tested part way through the year to get an indication of how the plan is faring for the year.

If testing is not done until after W-2s are issued, a revised W-2 should be issued and employees may have to file amended returns.

HRA/FSA nondiscrimination - Code section 105(h)

Q7: The 70% eligible is taking into consideration the allowable excludables, right? (such as part timers).

A7: That is correct. The eligibility test for HRA plans is passed if 70% of all employees that are not excludibles benefit under the plan.

Q8: If 50% of the employees choose to receive the money as pay and not put in plan, then the plan would be deemed to be discriminatory?

A8: I assume this question is referring to 70% benefits test for code section 105. The plan may be discriminatory. It does not meet the 70% test and would also not meet the 80% test (80% must benefit if at least 70% are eligible - 56% of all employees would benefit at a minimum under the 80% test). You would need to look at the benefits classification test - a facts and circumstances consideration as found under 410(b)(1)(B).

Q9: Your slide stated "maximum reimbursement must be uniform for all participants – may not be modified by age or years of service". Does this mean that if a company sets up a $2400 maximum election they are not allowed to state that after 5 years of service it will increase to $4800? Does it matter if the employer is a doctor's office and they employ admin staff, RNs and the doctor? In this situation none of the employees will change category based on years of service so it is more a benefit for those who have longevity. Can you share your thoughts?

A9: While I certainly would agree that your fact situation does not seem to discriminate in favor of HCEs on its face, the 1.105-11 regulations (excerpted in relevant part below) prohibit modifying maximum reimbursements based on years of service or age (whether or not HCEs are even eligible for the plan). I suppose the regulations are assuming that those with the greatest amount of service and/or the oldest employees will tend to be more highly compensated.

1.105-11(c)(3) (emphasis added):

> A plan may establish a maximum limit for the amount of reimbursement which may be paid a participant for any single benefit, or combination of benefits. However, any maximum limit attributable to employer contributions **must be uniform** for all participants and for all dependents of employees who are participants and **may not be modified by reason of a participant's age or years of service**.

Q10: Maximum reimbursement... amount allowed? or amounts elected?

A10: Maximum reimbursement refers to the maximum allowable reimbursement under the plan.

Q11: how do you calculate the "excess" reimbursement?

A11: It depends:

If the HCE has received a discriminatory benefit (a benefit that is/was not available to NHCEs), then the entire discriminatory benefit is an excess reimbursement. An example of a discriminatory benefit is on slide 9 of the presentation (regarding PLR 8423036).

If the HCE has received benefits from a plan that is discriminatory in terms of eligibility, then the HCE's total benefits (reimbursements under the plan) multiplied by a ratio of the discriminatory benefits in the plan are the excess benefit. The ratio is determined by dividing the total reimbursement to HCEs by the total reimbursement under the plan to all participants.

Q12: Do the 105(h) regulations allow the Benefits Discrimination Test to be applied on the basis of availability rather than utilization?

A12: The benefits test is generally applied on the basis of availability: all benefits under the plan must be provided to NHCEs that are offered to HCEs; optional benefits must be provided to all eligible participants; maximum benefits must be uniform for all participants. However, the plan may not actually discriminate in operation - where a facts and circumstances test will apply that may take into account actual utilization and other operations of the plan.

Q13: On the benefits test, if a company has different waiting periods, does that company automatically fail the benefits test?

A13: This question could be applicable to section 105 or 125, I will address similar questions for cafeteria plans below so I decided to categorize this one as relating to section 105... Under section 105, this is likely a problem. HCEs are entering the plan before NHCEs will have an excess reimbursement for any reimbursements received during the longer waiting period for any NHCEs. See PLR 8423036 and slide 9 of the presentation.

Q14: I have several questions regarding the applicability of the non-discrimination rules to HRAs established with Collectively Bargained (CB) or combination CB/non-CB groups, potentially for retirees only.

A14: I will address each specific question below - but first want to point out that I am assuming the collectively bargained employees meet the requirements for

exclusion from the eligibility test under section 105. This means that the HRA (or any other section 105 plan) must actually be a subject of the collectively bargained agreement.

- **Are HRAs established for just CB employees subject to non-discrimination testing?**

A: If highly compensated employees are eligible for the plan, then the plan would still have to meet the benefits test but the plan would not have to meet the eligibility test.

- **Are HRAs established for just retirees subject to non-discrimination testing, with the employer contribution given upon retirement?**

A: Sort of. 1.105-11(c)(3)(iii) exempts benefits for retirees from nondiscrimination testing but then goes on to require that if any retirees were highly compensated, the benefits provided to former HCEs must be the same type and have the same dollar limitations as former NHCEs.

- **For an HRA established for active employees including both CB employees and non-CB employees, do the CB participants have to be tested in with the non-CB?**

A: As mentioned above, the CB employees may be excluded from the eligibility test but would be included in the benefits test.

Cafeteria plan nondiscrimination - Code section 125

Q15: under the key employee test, what is included in the qualified benefits? just the fsa election or all elections (premium payments...)?

A15: All qualified, nontaxable benefits are included.

Q16: If you carry your % to 3 or 4 (or more) decimal places, and the 25% test comes out to 25.50 or higher, is that considered a failed test since this would be 26% rounded?

A16: I assume this question is referring to the 25% limit for key employee benefits in a cafeteria plan. The regulations do not specify what rounding rules should apply. I would therefore, recommend not rounding. If the test results in 25.01% of nontaxable benefits are attributable to key employees, I would assume that the test failed.

Q17: Cafeteria tests: for eligibility and benefits tests, do you combine "benefits" for medical plan with hfsa or do you test each underlying benefit seperately?

A17: There is some flexibility in terms of how to test plans since the regulations do not actually indicate how this must be done. I could see either way of testing would work (combining all benefits and/or separating out each account type for testing individually). The nondiscrimination rules are written to apply broadly to the entire plan but if each separate benefit/account type passes the nondiscrimination rule, then the plan as a whole should be fine. If, however, one account type does not pass a nondiscrimination rule, then you will need to look at the plan as a whole to determine if it passes nondiscrimination.

Q18: How do you handle cafeteria plan tests if each underlying benefit has different eligibility rules?

A18: I assume the question refers to the typical example where the premium conversion portion of the plan may be tied to the underlying insurance contracts (with a 30 day wait for one contract and 90 day wait for another, possibly) and eligibility for all other benefits (FSA, dependent care) may be uniform (perhaps 6 months of service). I will also assume that the eligibility exclusions are uniform for all benefit types (i.e. if leased employees are not eligible for one benefit, they are not eligible for all benefits under the plan). Note that the uniform election opportunity requirement will prohibit having different waiting periods for the same benefit (i.e. one group of employees should not have a longer wait for entry into the FSA than other employees). I'll discuss the scenario as it relates to each test:

The key employee test should work regardless of underlying eligibility for the different benefits. As mentioned above, you could test each for the 25% test and if all pass, then the plan is fine. If one does not pass, then you could combine all the numbers to get an overall result for the plan.

The eligibility test is a measure of those benefiting under the plan compared to those eligible. As mentioned above, the regulations do not define what it means to "benefit" for purposes of the eligibility test. It is reasonable to assume that a participant is benefiting for purposes of the test if they are eligible for any of the benefits under the plan. (Other interpretations may also be reasonable - I am just suggesting one here.)

The benefits test is determined without regard to waiting periods so this fact pattern should not affect the ability to run the benefits test.

Q19: Hi - I have a question that seems to come up regarding Section 125 and Premium Only Plans (or the premiums portion of a Section 125 that includes FSA as well as insurance). Invariably employers in practice put waiting

periods on benefits such as 90 days for hourly, immediate for salaried. Is this technically discriminatory? I have tried to address this by telling the employers to have the same waiting period for all or telling them that for the first 90 days in this example a salaried person would have to do post tax and then pre-tax after 90 days

A19: This is certainly a creative solution... I would agree that having different waiting periods is likely problematic under the benefits test since benefits must be provided so that all employees have a "uniform election opportunity". If one employee can elect to have premiums paid pre-tax 90 days sooner than another employee for the same insurance policy, this would not be uniformly available.

Q20: Cafeteria plans: What if an employer has subsidiary corporations -- must they all be tested together or can they be tested seperately?

A20: Control groups are treated as a single plan for testing. However, note that this requirement will only affect eligibility testing.

Q21: if cafeteria plan fails tests, how do you "value" the benefits? Is it what the employee would contribute that gets taxed or is it the whole (ee + er contributions combined) that is taxable to the employee? "value" of taxable benefits is the contribution amount?

A21: If the plan has no employer contributions, then the value of the benefits are simply the total employee pre-tax contributions. If there are employer contributions, then the value of the benefits are the employee contributions, plus the cash-value of the employer contributions. The regulations (1.125-7(m)(2)) on this point provides as follows:

> A highly compensated participant or key employee participating in a discriminatory cafeteria plan must include in gross income (in the participant's taxable year within which ends the plan year with respect to which an election was or could have been made) the value of the taxable benefit with the greatest value that the employee could have elected to receive, even if the employee elects to receive only the nontaxable benefits offered.

I personally do not think the regulation is all that well-written but I believe that it is trying to say that the HCEs/Key employees will be taxed as though they did not participate in the plan (as if they opted out of all the qualified benefits available under the plan).

Q22: If plan fails concentration test, are all key employees taxed on all their pretax 125 contributions?

A22: Yes.

Q23: How does the Health care safe harbor apply? especially in a situation where there is a choice between an HRA with an upfront deductible health plan and a traditional HMO, both underlying plans funded in part through pre-tax contributions?

A23: This is a safe harbor available under the regulations that I did not discuss during the webinar. For reference, I will paste the entire rule found at 1.125-7(e), below:

> Safe harbor for cafeteria plans providing health benefits.
> (1) In general. A cafeteria plan that provides health benefits is not treated as discriminatory as to benefits and contributions if:
> (i) Contributions under the plan on behalf of each participant include an amount which equals 100 percent of the cost of the health benefit coverage under the plan of the majority of the highly compensated participants similarly situated, or equals or exceeds 75 percent of the cost of the health benefit coverage of the participant (similarly situated) having the highest cost health benefit coverage under the plan, and
> (ii) Contributions or benefits under the plan in excess of those described in paragraph (e)(1)(i) of this section bear a uniform relationship to compensation.
> (2) Similarly situated. In determining which participants are similarly situated, reasonable differences in plan benefits may be taken into account (for example, variations in plan benefits offered to employees working in different geographical locations or to employees with family coverage versus employee-only coverage).
> (3) Health benefits. Health benefits for purposes of this rule are limited to major medical coverage and exclude dental coverage and health FSAs.

As provided in the question, the two options are funded, at least in part by participants. Therefore, in order to meet the safe harbor, the sponsor must contribute to all participants one of the following:

- an amount that is at least 75 percent of the cost of the health benefit coverage of the participant (similarly situated) having the highest cost health benefit coverage under the plan; or
- an amount which equals 100 percent of the cost of the health benefit coverage under the plan of the majority of the highly compensated participants similarly situated.

I would interpret the "similarly situated" comparison to mean that the HRA and HMO are each tested separately - and additional separations could be possible, depending on the group, etc.

Q24: can you set up one 125 plan with a health plan for salaried and a health plan for hourly or would you have to set up two 125 plans?

A24: Either approach is possible - neither is simple. If two separate plans are set up - all (non-excludible) employees will be considered for the eligibility test of each plan. If one plan is set up, you may have an easier time with eligibility but benefits tests will likely become a problem. If the "health plan" is not an FSA, then you may be able to utilize the safe harbor above -- although my guess is that the safe harbor will not be met under this scenario.

Q25: The regs mention disaggregation for ees <3yrs of service - is this mandatory or optional? What other types of disaggregation are allowed or required?

A25: The disagregation rule for employees with less than three years of service is optional (see 1.125-7(g)). There is an additional option to aggregate plans of an employer for testing under 1.125-7(h), pasted in full below:

> Optional aggregation of plans for nondiscrimination testing. An employer who sponsors more than one cafeteria plan is permitted to aggregate two or more of the cafeteria plans for purposes of nondiscrimination testing. If two or more cafeteria plans are aggregated into a combined plan for this purpose, the combined plan must satisfy the nondiscrimination as to eligibility test in paragraph (b) of this section and the nondiscrimination as to contributions and benefits test in paragraph (c) of this section, as though the combined plan were a single plan. Thus, for example, in order to satisfy the benefit availability and benefit election requirements in paragraph (c)(2) of this section, the combined plan must give each similarly situated participant a uniform opportunity to elect qualified benefits and the actual election of qualified benefits by highly compensated participants must not be disproportionate. However, if a principal purpose of the aggregation is to manipulate the nondiscrimination testing requirements or to otherwise discriminate in favor of highly compensated individuals or participants, the plans will not be permitted to be aggregated for nondiscrimination testing.

Q26: You mentioned that for 125 Benefits testing, HCEs cannot be favored in total benefits, employer contributions, or qualified benefits.

The regs indicate that a plan does not discriminate with respect to contributions and benefits if EITHER qualified benefits and total benefits OR statutory non-taxable benefits and employer contributions (including pre-tax ee contributions?) allocable to total benefits do not favor HCEs - on the basis of both availability and utilization.

The example in the reg appears to look at "aggregate qualified benefits" as a percent of pay. is this measured as total cost? employer contribution? and there is no mention of uniform election for similarly situated -is this assumed or is this part of the non-discrimination as to eligibility? Is there a more detailed example anywhere?

A26: I agree that the regulations are not clear and the example provided in the relevant section (1.125-7(c)(3)) is not too helpful in explaining all the details, but I'm afraid there isn't anything else out there official right now. We must hope that the regulations (if ever finalized) will be clearer.

I think the regulations are actually providing conflicting guidance. As you point out the first part of the regulations provide an option to test employer contributions OR qualified benefits selected. However, if you read further, the regulations seem to imply that BOTH qualified benefits and employer benefits must be nondiscriminatory (the regulation says "must also").

I'm excerpting the relevant part (1.125-7(c)(2)) below, adding emphasis and breaking up the text to make it more read-able:

> (2) Benefit availability and benefit election.
>
> A cafeteria plan does not discriminate with respect to contributions and benefits **if either qualified benefits and total benefits, or employer contributions allocable to statutory nontaxable benefits and employer contributions allocable to total benefits**, do not discriminate in favor of highly compensated participants.
>
> A cafeteria plan must satisfy this paragraph (c) with respect to both benefit availability and benefit utilization. Thus, **a plan must give each similarly situated participant a uniform opportunity to elect qualified benefits, and the actual election of qualified benefits through the plan must not be disproportionate** by highly compensated participants (while other participants elect permitted taxable benefits). Qualified benefits are disproportionately elected by highly compensated participants if the aggregate qualified benefits elected by highly compensated participants, measured as a percentage of the aggregate compensation of highly compensated participants, exceed the aggregate qualified benefits elected by nonhighly compensated participants measured as a percentage of the aggregate compensation of nonhighly compensated participants. **A plan must also give each similarly situated participant a uniform election with respect to employer contributions, and the actual election with respect to employer contributions for qualified**

> **benefits through the plan must not be disproportionate** by highly compensated participants (while other participants elect to receive employer contributions as permitted taxable benefits). Employer contributions are disproportionately utilized by highly compensated participants if the aggregate contributions utilized by highly compensated participants, measured as a percentage of the aggregate compensation of highly compensated participants, exceed the aggregate contributions utilized by nonhighly compensated participants measured as a percentage of the aggregate compensation of nonhighly compensated participants.

The example (1.125-7(c)(3)):

> Contributions and benefits test. Employer C's cafeteria plan satisfies the eligibility test in paragraph (b) of this section. Highly compensated participants in the cafeteria plan elect aggregate qualified benefits equaling 5 percent of aggregate compensation; nonhighly compensated participants elect aggregate qualified benefits equaling 10 percent of aggregate compensation. Employer C's cafeteria plan passes the contribution and benefits test.

We do not know if there are any employer contributions in the example provided, so it does not really shed light on the conflicting language above (whether you can just test qualified benefits or employer contributions - or whether both must be tested). The example is measuring the dollar amount of qualified benefits divided by compensation.

You are also correct in that the example does not explain the uniform benefit availability requirement - but I would argue that this requirement is relatively straightforward. You must offer all benefits in the same way to all similarly situated groups. Similarly situated is defined, for a different purpose, at 1.125-7(e)(2) (and pasted above in Q&A 23) -- the same meaning logically could also apply here.

Q27: My understanding is that the contributions made to the qualified benefit plans (employee pre tax and employer) provided under the Section 125 plan must be considered for testing. For example, if the plan does not pass the concentration test, key employees have to recognize the value of the qualified benefits elected under the plan not just the employee's pre-tax contribution. Thus, the additional taxable event for someone who elects family medical, dental, DCFSA and HSA (employee and employer contributions) can be significant, not to mention late penalties, amended returns, etc.

A27: If a cafeteria plan fails nondiscrimination, you are correct: key/HCE employees have to recognize the value of the qualified benefits elected under the

plan... not just the employee's pre-tax contribution if there are employer contributions to the plan.

I perhaps should not have minimized the penalties for failing nondiscrimination, I simply meant to put it in perspective the extremely complicated rules with the more limited penalties when compared to qualified plan penalties. Cafeteria plans provide a limited benefit.... in general, it's the underlying plans/arrangements that provide the actual benefits. In addition, if an HCE/key is taxed under the cafeteria plan, it does not mean that the employee is no longer eligible for the "underlying" tax benefit. The employee may still be able to take a deduction for medical expenses, dependent care expenses, etc.

Other questions

Q28: Isn't there 3 subtests for the Eligibility Test? Employment Requirement, Entry Requirement and the NonDiscriminatory Classification Test?

A28: I'm not really sure what these subtests are referring to. My training materials are based on the current proposed cafeteria plan nondiscrimination regulations at 1.125-7, section 125, section 105 and 1.105-11. My guess is that these "subtests" are from other training materials that are interpreting the nondiscrimination rules.

Q29: will you be offering ndt software for cafeteria ndt?

A29: We do not have plans to offer welfare plan nondiscrimination testing software at this time.

Q30: So what is the aim when cafeteria plans are generally exempt from 5500 filing requirements, and when we see from experience that not too many 125 plans are audited by the IRS? I am not saying we don't do the required testing, as we do in fact do so, but many clients ask why? All we can tell them is that the testing is necessary to remain in compliance with the Code and Regs.

A30: Sounds reasonable.

Q31: are the new 125 discrimination rules effective for post 2008 plan years?

A31: The new proposed cafeteria plan regulations are still proposed regulations on which employers "may rely".

Q32: One other question, any word on the street that there would be some simplication/overhaul of these rules overall? It seems likely in practice that complexity equals employers ignore the rules altogether.

A32: The cafeteria plan proposed rules are relatively new but also not yet finalized. It is certainly possible that the rules could be simplified when the regulations are finalized. I, however, think that is unlikely.

Q33: What is the "cash" aspect of a Section 125 plan? Could the "cash" also be what an employer offers to an employee for opting out of the medical plan?

A33: The cash aspect of a 125 plan is what the employee would get in cash and/or taxable benefits if the employee opted out of all qualified benefits under the plan. This would include the "opt out" amount if an employee chooses not to take the medical plan of an employer (if such opt out is provided for).

Q34: As a follow up to this fine Webinar discussion, would you outline the Dependent Care discrimination rules, because they can cause problems to the HCE or the Key employee and have totally different limits and/or percentage tests?

A34: There are not currently regulations describing the dependent care assistance (DPA) program nondiscrimination rules; there is only the code section 129(d) rule to guide us. Like the other nondiscrimination rules discussed, a DPA program must meet a benefits and eligibility test. I'm excerpting the relevant parts of Code section 129(d) below:

> (2) Discrimination.
> The contributions or benefits provided under the plan shall not discriminate in favor of employees who are highly compensated employees (within the meaning of section 414(q)) or their dependents.
> (3) Eligibility.
> The program shall benefit employees who qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of employees described in paragraph (2), or their dependents.
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> * * *
>
> (8) Benefits.
> (A) In general. A plan meets the requirements of this paragraph if the average benefits provided to employees who are not highly compensated employees under all plans of the employer is at least 55 percent of the average benefits provided to highly compensated employees under all plans of the employer.
> (B) Salary reduction agreements. For purposes of subparagraph (A), in the case of any benefits provided through a salary

reduction agreement, a plan may disregard any employees whose compensation is less than $25,000. For purposes of this subparagraph, the term “compensation” has the meaning given such term by section 414(q)(4) , except that, under rules prescribed by the Secretary, an employer may elect to determine compensation on any other basis which does not discriminate in favor of highly compensated employees.

(9) Excluded employees.

For purposes of paragraphs (3) and (8), there shall be excluded from consideration—

(A) subject to rules similar to the rules of section 410(b)(4) , employees who have not attained the age of 21 and completed 1 year of service (as defined in section 410(a)(3)), and

(B) employees not included in a dependent care assistance program who are included in a unit of employees covered by an agreement which the Secretary finds to be a collective bargaining agreement between employee representatives and 1 or more employees, if there is evidence that dependent care benefits were the subject of good faith bargaining between such employee representatives and such employer or employers.