

NONDISCRIMINATION TEST DEFINITIONS

PREMIUM ONLY PLAN TESTING

Cafeteria Plans (Section 125) - Key Employee Concentration Test (Test 1/3)

Nontaxable benefits provided to Key employees cannot exceed 25% of such benefits provided for all employees under the cafeteria plan. A Key employee is any employee who, during the plan year, was: an officer of the employer with annual compensation in excess of a specified dollar threshold, a more-than-5% owner of the employer; or a more-than-1% owner of the employer with annual compensation in excess of \$150,000 (not indexed).

Cafeteria Plans (Section 125) - Eligibility Test (Employment and Entry Requirements) - Test 2A/3

This test checks if a reasonable number of non-highly compensated individuals (HCIs) are eligible to participate in the cafeteria plan. The HCI group is made of officers, more-than-5% shareholders, HCIs, and spouses or dependents of such individuals. A plan does not discriminate if it meets three requirements: (A) No employee is required to complete more than three years of employment to participate, and the same employment requirement applies to all employees (the Employment Requirement); (B) Entry into the cafeteria plan is not delayed (the Entry Requirement); and (C) The plan meets a nondiscriminatory classification test (the Nondiscriminatory Classification Test). This test covers requirements (A) and (B).

Cafeteria Plans (Section 125) - The Eligibility Test (Nondiscriminatory Classification Test) - Test 2B/3

A plan satisfies the Nondiscriminatory Classification Test for a plan year if: (1) The plan benefits employees who qualify under a reasonable classification established by the employer; and (2) The classification of employees is nondiscriminatory. (If the plan's Ratio Percentage is greater than 50% or is greater than the applicable Safe Harbor Percentage, the plan automatically passes the Safe Harbor Percentage Test; otherwise, the plan may still pass based on facts and circumstances.)

Cafeteria Plans (Section 125) - The Contributions and Benefits Test - Availability and Utilization - Test 3/3

This test ensures that contributions and benefits are available on a nondiscriminatory basis and that highly compensated participants (HCPs) do not select more nontaxable benefits than non-HCPs do. HCPs are the following employees who actually participate in the plan: officers, more-than-5% shareholders, the highly compensated, and spouses and certain tax dependents of individuals in these categories.

In order to satisfy the availability test, the plan must demonstrate that either employer contributions are available on a nondiscriminatory basis or benefits are available on a nondiscriminatory basis.

Utilization Test: The actual election of qualified benefits through a cafeteria plan must not be disproportionate by HCPs. For this purpose, two ratios must be calculated and compared - the aggregate qualified benefits elected (or employer contributions utilized, as applicable) divided by the aggregate compensation - for the HCP and non-HCP groups, respectively. The HCP ratio must be less than or equal to the non-HCP ratio.

BASIC FSA/DCA TESTING

Cafeteria Plans (Section 125) - Key Employee Concentration Test (#1 of 3 Cafeteria Plan Tests; refer to Comprehensive for #2 and #3)

Nontaxable benefits provided to Key employees cannot exceed 25% of such benefits provided for all employees under the plan. A Key employee is any employee who, during the plan year, was: an officer of the employer with annual compensation in excess of a specified dollar threshold, a more-than-5% owner of the employer; or a more-than-1% owner of the employer with annual compensation in excess of \$150,000 (not indexed).

Dependent Care (Section 129) - The More than 5% Owners Concentration Test - (#3 of 4 DCA Tests; refer to Comprehensive for #1 and #2)

DCAP benefits provided to more-than-5% owners cannot exceed 25% of such benefits provided for all employees under the plan. Otherwise, the plan will be discriminatory and the HCEs will lose their DCAP benefit exclusion and will have the DCAP amounts included in gross income. All benefits provided during the year should be taken into account, even if received by employees whose employment terminated during the year.

Dependent Care (Section 129) - The 55% Average Benefits Test - (#4 of 4 DCA Tests; refer to Comprehensive for #1 and #2)

The 55% Average Benefits Test is meant to ensure that HCEs do not participate disproportionately and focuses on the average (per capita) benefit received by HCEs compared to that received by non-HCEs. A plan meets the requirements if the average benefits provided to employees who are non-HCEs under all DCAP plans of the employer is at least 55% of the average benefits provided to HCEs under all DCAP plans of the employer.

COMPREHENSIVE CAFETERIA PLAN TESTING

(INCLUDES ALL PREMIUM ONLY PLAN AND BASIC FSA/DCA TESTING ABOVE IN ADDITION TO THE FOLLOWING)

Dependent Care (Section 129) - The Eligibility Test - Test 1/4

The Eligibility Test ensures that a reasonable percentage of non-highly-compensated-employees (HCEs) are eligible to participate in the DCAP. HCEs are employees whose compensation during the preceding plan year exceeded the HCE Dollar Threshold for that year or who were more-than-5% owners in the current or preceding plan year. A two-part Nondiscriminatory Classification Test is applied requiring: (i) The plan benefits employees who qualify under a reasonable classification established by the employer; and (ii) The classification of employees is nondiscriminatory (If the plan's Ratio Percentage is greater than 50% or is greater than the applicable Safe Harbor Percentage, the plan automatically passes the Safe Harbor Percentage Test. Otherwise, the plan may still pass based on facts and circumstances.)

Dependent Care (Section 129) - The Contributions and Benefits Test - Test 2/4

Contributions and benefits provided under a DCAP may not discriminate in favor of HCEs or their dependents. The test examines the benefits (and contributions) received under the DCAP and whether prohibited group members participating in the DCAP receive a better benefit or contribution than do the other participants, which is a facts and circumstances analysis.

Health FSA (Section 105h) - The Eligibility Test - Test 1/2

Under the Eligibility Test, the Health FSA cannot discriminate in favor of highly compensated individuals (HCIs) as to eligibility to participate. To belong to the HCI group, the employee must be one of the following: (i) one of the five highest paid officers in the current year based upon facts and circumstances (e.g., authority) not necessarily title; (ii) A shareholder who owns more than 10% of the value of stock of the employer's stock; or (iii) is among the highest paid 25% of all employees (other than excludable employees who are not participants). A health FSA may pass under any one of three tests:

- (A) 70% Test. The plan benefits 70% or more of all non-excludable employees.
- (B) 70%/80% Test. The plan benefits 80% or more of all non-excludable employees who are eligible to benefit, if 70% or more of all non-excludable employees are eligible to benefit under the plan.
- (C) Nondiscriminatory Classification Test. The plan benefits a nondiscriminatory classification of employees. This requires a bona fide business classification for any exclusion and a sufficient ratio of benefiting non-HCIs to benefiting HCIs. If the plan's Ratio Percentage is greater than 50% or is greater than the applicable Safe Harbor Percentage, the plan automatically passes the Safe Harbor Percentage Test. Otherwise, the plan may still pass based on facts and circumstances.

Health FSA (Section 105h) - The Benefits Test - Test 2/2

Under the Benefits Test, benefits provided under a health FSA must not discriminate in favor of participants who are HCIs. The Benefits Test consists of two requirements, both of which must be met in order for the health FSA to pass the Benefits Test:

- (A) Nondiscrimination on the face of the plan, which includes: (i) The required employee contributions must be identical for each benefit level; (ii) The maximum benefit level that can be elected cannot vary based on percent of compensation, age, or years of service; (iii) The same type of benefits (e.g., medical expenses) provided to HCIs must be provided to all other participants; and (iv) Disparate waiting periods cannot be imposed.
- (B) Nondiscrimination in operation. This is a "facts and circumstances" determination. Discrimination in operation "may occur where the duration of a particular benefit coincides with the period during which [an HCI] utilizes the benefit."