

Prop. Reg. Section 1.125-7(b)(3)(iv), Example 1

Cafeteria plan nondiscrimination rules.

(b) *Nondiscrimination as to eligibility* --(1) *In general*. A cafeteria plan must not discriminate in favor of highly compensated individuals as to eligibility to participate for that plan year. A cafeteria plan does not discriminate in favor of highly compensated individuals if the plan benefits a group of employees who qualify under a reasonable classification established by the employer, as defined in § 1.410(b)-4(b), and the group of employees included in the classification satisfies the safe harbor percentage test or the unsafe harbor percentage component of the facts and circumstances test in § 1.410(b)-4(c). (In applying the § 1.410(b)-4 test, substitute highly compensated individual for highly compensated employee and substitute nonhighly compensated individual for nonhighly compensated employee).

(2) *Deadline for participation in cafeteria plan*. Any employee who has completed three years of employment (and who satisfies any conditions for participation in the cafeteria plan that are not related to completion of a requisite length of employment) must be permitted to elect to participate in the cafeteria plan no later than the first day of the first plan year beginning after the date the employee completed three years of employment (unless the employee separates from service before the first day of that plan year).

(3) *The safe harbor percentage test* --(i) *In general*. For purposes of the safe harbor percentage test and the unsafe harbor percentage component of the facts and circumstances test, if the cafeteria plan provides that only employees who have completed three years of employment are permitted to participate in the plan, employees who have not completed three years of employment may be excluded from consideration. However, if the cafeteria plan provides that employees are allowed to participate before completing three years of employment, all employees with less than three years of employment must be included in applying the safe harbor percentage test and the unsafe harbor percentage component of the facts and circumstances test. See paragraph (g) of this section for a permissive disaggregation rule.

(ii) *Employees excluded from consideration*. In addition, for purposes of the safe harbor percentage test and the unsafe harbor percentage component of the facts and circumstances test, the following employees are excluded from consideration--

(A) Employees (except key employees) covered by a collectively bargained plan as defined in paragraph (a)(11) of this section;

(B) Employees who are nonresident aliens and receive no earned income (within the meaning of section 911(d)(2)) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3)); and

(C) Employees participating in the cafeteria plan under a COBRA continuation provision.

(iv) *Examples.* The following examples illustrate the rules in paragraph (b) of this section:



Example 1.

Same qualified benefit for same salary reduction amount. Employer A has one employer-provided accident and health insurance plan. The cost to participants electing the accident and health plan is \$ 10,000 per year for single coverage. All employees have the same opportunity to salary reduce \$ 10,000 for accident and health plan. The cafeteria plan satisfies the eligibility test.

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