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Employee Benefits – Question of the Month

February 2018

Q: I was told that our company's owners cannot be in the Health FSA if they own more than 2% of the company. Is this true? Our two company owners are both participating in the Health FSA. We are an S-Corp if that matters.

A: Individuals that have at least a 2% ownership in an S corporation (and their immediate family members) are prohibited from participating in a cafeteria plan. It appears your company's owners may fall into this category, but we recommend consulting an attorney or accountant to make sure.

Assuming they are 2% shareholders in an S corporation, your company's owners should not be allowed to:

- Pay their premiums on a pre-tax basis;
- Contribute to a Health Care FSA or Dependent Care FSA;
- Contribute to a Health Savings Account through the cafeteria plan.

If other family members of the owners also work for the company, they are also prohibited from participating in the cafeteria plan – even if they don't have an ownership interest. This includes the 2% owners' spouse, children, grandchildren, and parents. This is due to attribution rules found in the tax code. Note that the same rules also apply – to varying degrees – to partners in a partnership and their families.

However, there may still be a way for 2% owners and their families to get some tax benefits. HSAs, for example, offer tax benefits even if contributions are made outside of a cafeteria plan. You would want to consult your accountant, attorney, and/or cafeteria plan administrator on how to set that up appropriately.

In addition, there is a way to structure the employer's payment of a 2% owner's premiums so that they are deductible by the owner. There is a good discussion of this on the [IRS' website](#).

It appears your company's owners may be in violation of the cafeteria plan regulations by participating in the plan. We strongly advise consulting an attorney to determine how to proceed. In general, you may need to reverse contributions made to the plan by or on behalf of the owners, and they may have to pay back taxes on the newly reported income.

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