COMPLIANCE OVERVIEW

Health Plan Rules—Treating Employees Differently

Some employers may want to be selective and treat employees differently for purposes of group health plan benefits. For example, employers may consider implementing the following plan designs:

- ☑ A health plan "carve-out" that insures only select groups of employees (for example, a management carve-out);
- ☑ Different levels of benefits for groups of employees; or
- ☑ Varied employer contribution rates based on employee group.

In general, employers may treat employees differently, as long as they are not violating federal rules that prohibit discrimination in favor of highly compensated employees. These rules currently apply to self-insured health plans and arrangements that allow employees to pay their premiums on a pre-tax basis. The nondiscrimination requirements for fully insured health plans have been delayed indefinitely.

Employers should also confirm that any health plan rules do not violate other federal laws that prohibit discrimination. In addition, employers with insured plans should confirm that carve-out designs comply with any minimum participation rules imposed by the carrier.

LINKS AND RESOURCES

- *Fully insured health plans:* No rules have been issued
- *Cafeteria plans:* IRS proposed rules from 2007
- *Self-insured health plans:* IRS rules under Code Section 105(h)

Health Plan Designs

These types of plan designs may be discriminatory:

- Only a select group of employees is eligible to participate;
- There are different benefits available to a select group of employees; or
- An employer contributes more of the cost of coverage for a select group of employees.

Nondiscrimination Rules

- Fully insured health plans are not subject to nondiscrimination testing.
- An employer's Section 125 plan must satisfy three different nondiscrimination tests to avoid adverse tax consequences.
- Self-insured health plans cannot discriminate in favor of highly compensated employees with respect to eligibility for benefits.

Health Plan Design—General Rules

Nondiscrimination Tests

In general, a health plan will not have problems passing any applicable nondiscrimination test when the employer treats all of its employees the same for purposes of health plan coverage (for example, all employees are eligible for the health plan, and the plan's eligibility rules and benefits are the same for all employees). However, treating employees differently may make it more difficult for a health plan to pass the applicable nondiscrimination tests. Examples of plan designs that may cause problems with nondiscrimination testing include:

- ☑ Only certain groups of employees are eligible to participate in the health plan (for example, only salaried or management employees);
- ☑ The health plan has different employment requirements for plan eligibility (for example, waiting periods and entry dates) for different employee groups;
- ☑ Plan benefits or contribution rates vary based on employment classification, years of service or amount of compensation (for example, management employees pay a lower premium or receive additional benefits); or
- ☑ The employer maintains separate health plans for different groups of employees.

Before implementing one or more of these plan designs, employers should confirm that the arrangement will comply with any applicable rules that prohibit discrimination in favor of highly compensated employees. Under currently applicable law, if a health plan is discriminatory, highly compensated employees will lose certain tax benefits under the plan.

> ***Impact of Common Ownership:*** For nondiscrimination testing purposes, the Internal Revenue Code (Code) treats two or more employers as a single employer if there is sufficient common ownership or a combination of joint ownership and common activity. Thus, if companies are part of the same controlled group or affiliated service group under Code Sections 414(b), (c) or (m), all employees of those companies must generally be included in the nondiscrimination testing.

Other Requirements

In addition, employers should confirm that their health plan design complies with other federal laws that prohibit discrimination, including the following:

- ☑ **Title VII** of the Civil Rights Act, which prohibits discrimination on the basis of race, color, religion, sex and national origin;
- ☑ The **Americans with Disabilities Act (ADA)**, which prohibits discrimination against qualified individuals based on disability;
- ☑ The **Age Discrimination in Employment Act (ADEA)**, which prohibits age discrimination against employees age 40 or older;

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- ☑ The **Health Insurance Portability and Accountability Act (HIPAA)**, which prohibits discrimination based on a health factor (such as health status, medical condition, claims experience, medical history, evidence of insurability or disability); and
- ☑ The **Medicare Secondary Payer (MSP) rules**, which require employers with 20 or more employees to offer the same benefits under the same conditions to current employees (or their spouses) who are age 65 or older that are provided to workers and spouses who are under age 65.

Employers with fully insured health plans should also confirm that their plan design complies with any requirements imposed by the carrier, such as restrictions on the type of carve-out group the carrier will accept and minimum participation requirements.

Fully Insured Health Plans

Currently, fully insured health plans are not subject to nondiscrimination testing. The Affordable Care Act (ACA) includes a requirement that non-grandfathered, fully insured group health plans follow many of the same nondiscrimination rules that have historically applied only to self-insured health plans under Code Section 105(h). These nondiscrimination rules were set to be effective for fully insured health plans for plan years beginning on or after Sept. 23, 2010. However, they have been delayed indefinitely, pending the issuance of regulations from the Internal Revenue Service (IRS).

Once the ACA's nondiscrimination rules become effective for fully insured group health plans, if an insured group health plan is discriminatory, the plan will be subject to an excise tax of $100 per day per individual discriminated against.

Because fully insured health plans are not subject to the Section 105(h) nondiscrimination rules, employers generally ***have more flexibility to treat employees differently*** under their fully insured group health plans. For example, some employers only make health plan coverage available to management employees or make coverage available to all employees, but provide better benefits (or charge lower premiums) to management employees.

Although the Section 105(h) rules do not apply to an employer's fully insured group health plan, the Section 125 nondiscrimination rules will apply if the health plan is offered through a cafeteria plan. If a Section 125 plan is discriminatory, highly compensated employees' health plan contributions will be taxable. To avoid this issue, highly compensated employees may want to make their premium contributions on an after-tax basis (outside of the Section 125 plan) or the coverage may be 100 percent employer-paid.

Section 125 Plans

A Section 125 plan, or a cafeteria plan, allows employees to reduce their compensation in order to pay for certain employee benefits, such as health plan coverage, on a pre-tax basis. To receive this tax advantage, the cafeteria plan must generally pass certain tests that are designed to ensure that the plan does not discriminate in favor of highly compensated employees. If a Section 125 plan fails to pass nondiscrimination testing, highly compensated employees lose the tax benefits of participating in the plan (that is, they must include the benefits or compensation in their income).

Under the Section 125 rules, a highly compensated employee generally means any individual who is:

- ☑ An officer;

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- ☑ A shareholder owning more than 5 percent of the voting power or value of all classes of stock of the employer;
- ☑ Highly compensated; or
- ☑ A spouse or dependent of a person described above.

An employee is considered "highly compensated" if he or she had compensation in excess of a specified dollar threshold for the preceding plan year, and, if elected by the employer, was also in the "top-paid group" of employees (that is, the top 20 percent). If the preceding plan year is 2019, the dollar threshold is **$125,000**. If the preceding plan year is 2020 or 2021, the dollar threshold is **$130,000**.

In general, a Section 125 plan must satisfy the following three nondiscrimination tests:

1	**Eligibility Test**	This test looks at whether a sufficient number of non-highly compensated employees are eligible to participate in the cafeteria plan. If too many non-highly compensated employees are ineligible to participate, the plan will fail this discrimination test.
2	**Benefits and Contributions Test**	This test is designed to make sure that a plan's contributions and benefits are available on a nondiscriminatory basis and that highly compensated employees do not select more nontaxable benefits than non-highly compensated employees select.
3	**Key Employee Concentration Test**	This test looks at whether key employees impermissibly utilize the plan's benefits more than non-key employees. Under this test, key employees must not receive more than 25 percent of the aggregate nontaxable benefits provided to all employees.

Certain exceptions and safe harbors apply to the cafeteria plan nondiscrimination tests. Because these tests are so complex, employers should work with their benefit advisors or legal counsel when performing cafeteria plan nondiscrimination testing.

Self-Insured Health Plans

Self-insured health plans are subject to nondiscrimination requirements under Code Section 105(h). A self-insured health plan is an accident or health plan that reimburses medical care expenses and does not provide this reimbursement through an insurance policy. It includes self-insured group medical plans, as well as most health flexible spending accounts (health FSAs) and health reimbursement arrangements (HRAs).

Under Section 105(h), a self-insured health plan cannot discriminate in favor of highly compensated employees with respect to eligibility or benefits. If a self-insured health plan is discriminatory, highly compensated employees will be taxed on their "excess reimbursements."

For purposes of Section 105(h) testing, a highly compensated employee means an individual who is:

- ☑ One of the five highest-paid officers;
- ☑ A shareholder who owns more than 10 percent in value of the stock of the employer; or

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- ☑ Among the highest-paid 25 percent of all employees.

The eligibility test looks at whether a sufficient number of non-highly compensated employees benefit under a self-insured health plan. Section 105(h) provides three different ways for a self-insured health plan to pass the eligibility test.

1	**70 Percent Test**	The plan benefits 70 percent or more of all non-excludable employees.
2	**70 Percent/80 Percent Test**	The plan benefits 80 percent or more of all non-excludable employees who are eligible to benefit under the plan, if 70 percent or more of all non-excludable employees are eligible to benefit under the plan.
3	**Nondiscriminatory Classification Test**	The plan benefits a classification of employees that does not discriminate in favor of highly compensated employees. A plan satisfies this test if it has: • A bona fide business classification for any exclusions (for example, specified job categories, compensation categories or geographic location); and • A sufficient ratio of benefitting non-highly compensated employees to benefitting highly compensated employees.

The benefits test analyzes whether the plan provides highly compensated employees with better benefits, either in terms of how the plan is designed or how it operates. A health plan does not satisfy Section 105(h) nondiscrimination testing unless ***all the benefits provided to participants who are highly compensated employees are provided for all other participants***. In addition, all the benefits available for the dependents of highly compensated employees must be available on the same basis for the dependents of all other employees who are participating in the plan.

Because Section 105(h) testing is complex, employers with self-insured plans should work with their benefit advisors when performing this nondiscrimination testing. There are some permitted ways to structure health plan benefits in a way that favors highly compensated employees (for example, a separate fully insured group health plan for management employees offered outside of a cafeteria plan), but due to the complicated nature of the rules, employers may want to consult with legal counsel before implementing one of these designs.

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