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Review of Employee Benefit Plan Nondiscrimination Requirements

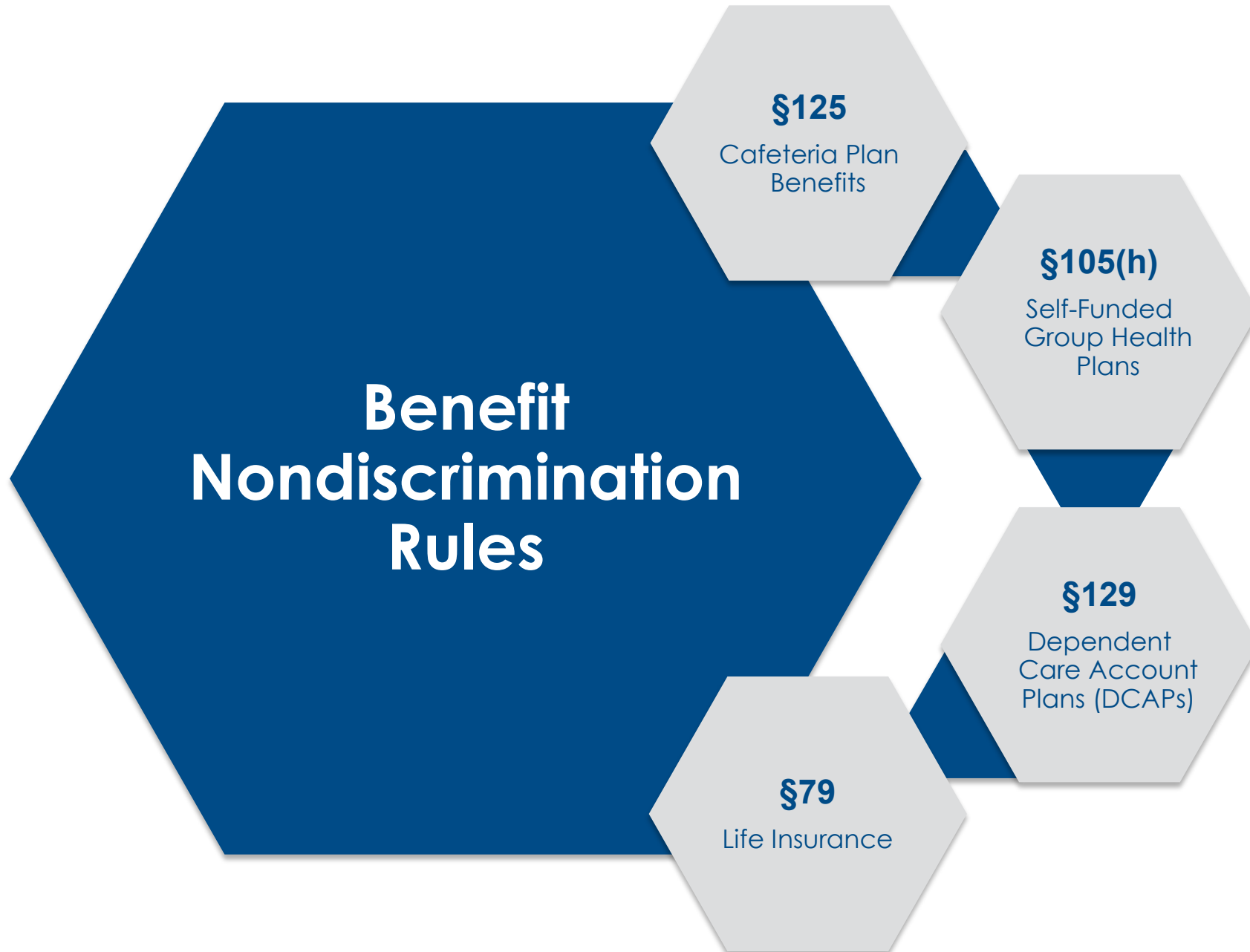
Compliance Series
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- **Common Question:** Can the employer differ _____ between classes of employees? Isn't that discriminatory?
- **Answer:** It's generally okay to differentiate eligibility, benefits and contributions between classes of employees so long as the employer doesn't discriminate against a protected class (e.g., age, race, religion, sex, health status)

Benefit Nondiscrimination Rules

- To offer benefits on a **tax-favored basis**, plans must be structured in accordance with benefit nondiscrimination rules
 - Benefit nondiscrimination rules restrict the ability to favor highly compensated individuals or key employees on tax-favored basis
 - Monitored and enforced by the IRS
 - Failure risks the highly compensated and key employees being taxed on benefits received under the discriminatory plan



Examples

Through a cafeteria plan, employer offers fully-insured medical, dental, vision, health FSA, HSA and dependent care FSA

- All benefits are aggregated and subject to §125 rules
- In addition, the health FSA is subject to §105(h) rules, and the dependent care FSA is subject to §129 rules

Employer offers fully-insured medical, dental and vision through a cafeteria plan. Employer also offers an HRA

- Medical, dental and vision plan are aggregated and subject to §125 rules
- The HRA is subject to §105(h) rules

Definitions

Highly Compensated Individuals (HCIs)

§125

Officers

>5% shareholders

Highly compensated (2020 - \$125,000 in 2019; 2021 - \$130,000 in 2020)*

§129

>5% shareholders

Highly compensated (2020 - \$125,000 in 2019; 2021 - \$130,000 in 2020)*

§105(h)

5 highest paid officers

>10% shareholders

Top 25% highest-paid employees

Key Employee

§125 and §79

Officers with annual compensation in excess of \$185,000 for 2020 and 2021

>5% owners

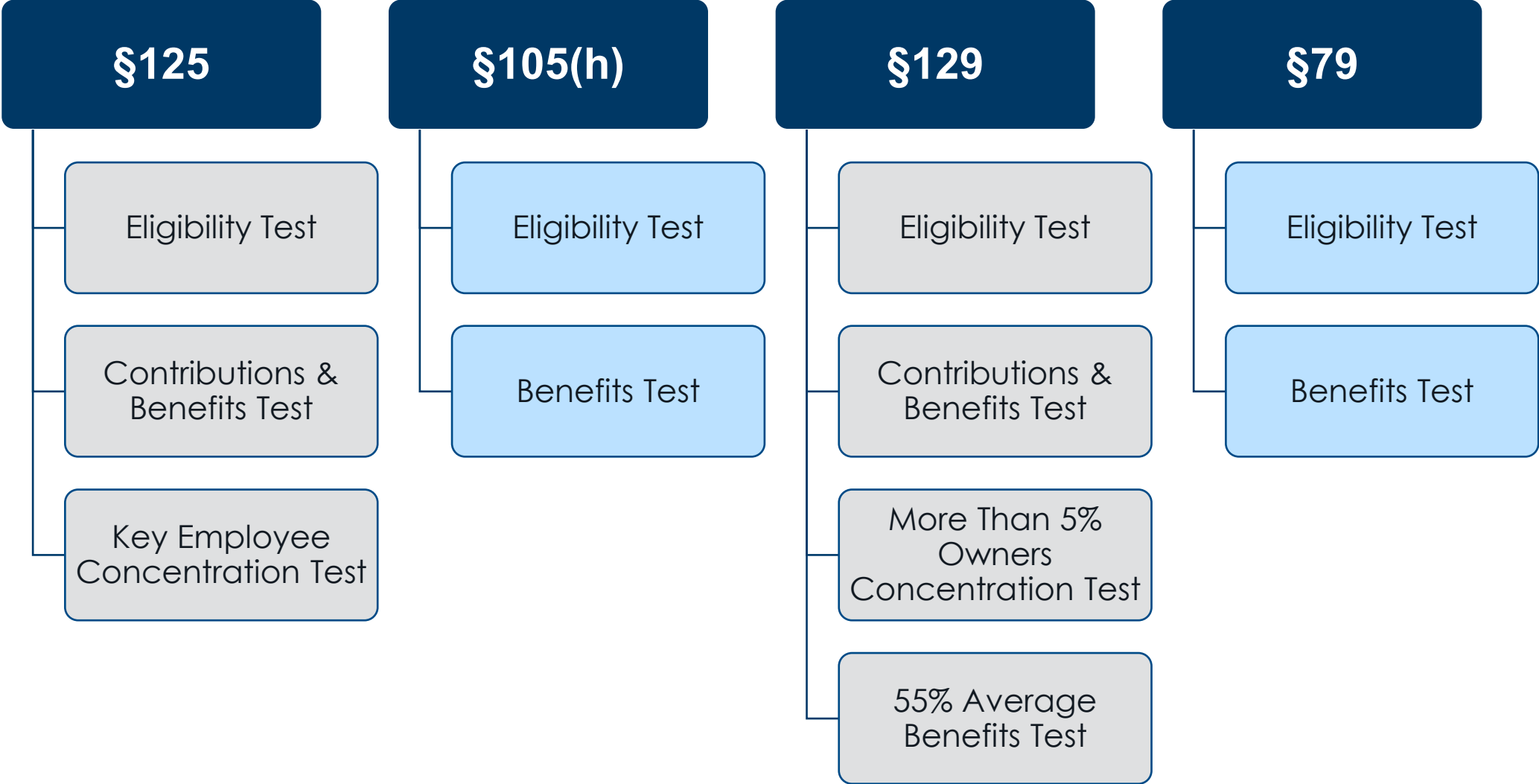
>1% owners with annual compensation in excess of \$150,000

**For §125 and §129, employers can make a top-paid election, choosing to count the top-paid 20% as HCIs rather than using the compensation threshold*

Owners & Non-Employees

- Exclude Owners & Non-Employees
 - Owners (e.g., sole proprietor, partner or >2% S-Corp shareholder) cannot participate on the same tax-favored basis as employees and are not considered for purposes of discrimination testing
 - Non-employees (e.g., board members, independent contractors) cannot participate on the same tax-favored basis as employees and are not considered for purposes of discrimination testing

Nondiscrimination Tests



§125 (3 Tests) – Cafeteria Plans

- Eligibility Test – Cannot discriminate as to eligibility to participate
 - Are enough non-HCIs eligible to benefit from the plan (including more generous contributions, if applicable)?
- Contributions & Benefits Test – Cannot discriminate as to contributions and benefits
 - Contributions and benefits must be available on a nondiscriminatory basis for similarly situated individuals, and HCIs cannot select more non-taxable benefits than non-HCIs
- Key Employee Concentration Test – Key employees cannot utilize more than 25% of the non-taxable benefits

****Premium only plan (POP) is only required to pass the eligibility test*

§105(h) (2 Tests) – Self-Funded Group Health Plans

- Eligibility Test – Cannot discriminate as to eligibility to participate (or benefit)
 - Are enough non-HCIs eligible to benefit from the plan (including more generous contributions, if applicable)?
- Benefits Test – Plan benefits provided cannot discriminate in favor of HCIs (no discrimination on the face of the plan or in operation)
 - Are all participants eligible for the same benefits under the plan?
 - Are all benefits offered under the same conditions to all participants?
 - If optional benefits are offered, are all participants able to elect each benefit option for the same additional contribution?
 - Are disparate waiting periods being used?
 - Do benefits vary based on age, years of service, or compensation?

§129 (4 Tests) – DCAPs

- Eligibility Test – Cannot discriminate as to eligibility to participate
 - Enough non-HCIs must be eligible to participate
- Contributions & Benefits Test – Cannot discriminate as to contributions and benefits
 - Enough non-HCIs must be offered the most generous annual limit and employer contribution
- More-Than-5% Owners Test – Owners cannot receive >25% of the benefits run through the plan
- 55% Average Benefits Test – Average benefits provided to the non-HCIs must be at least 55% of the average benefits provided to HCIs

§79 (2 Tests) – Group Life Plans

- Eligibility Test – Cannot discriminate as to eligibility to participate or benefit
 - Enough non-key employees must be able to benefit
- Benefits Test – Cannot discriminate as to contributions and benefits
 - All benefits available to key employees must be available to all other participants

Discrimination Testing - Timing

- No Clear Penalty for Failure to Test
 - §125 and §129 tests must be passed as of the last day of the plan year
 - §105(h) and §79 tests must be passed on all days during the plan year
 - If audited, must show the plan met nondiscrimination requirements

Conservative Approach

- Test at least annually
- Testing in the first half of the year leaves time to make corrections if needed

Practical Approach

- Run tests initially, but if plans pass, test again when there are significant changes in structure or participation

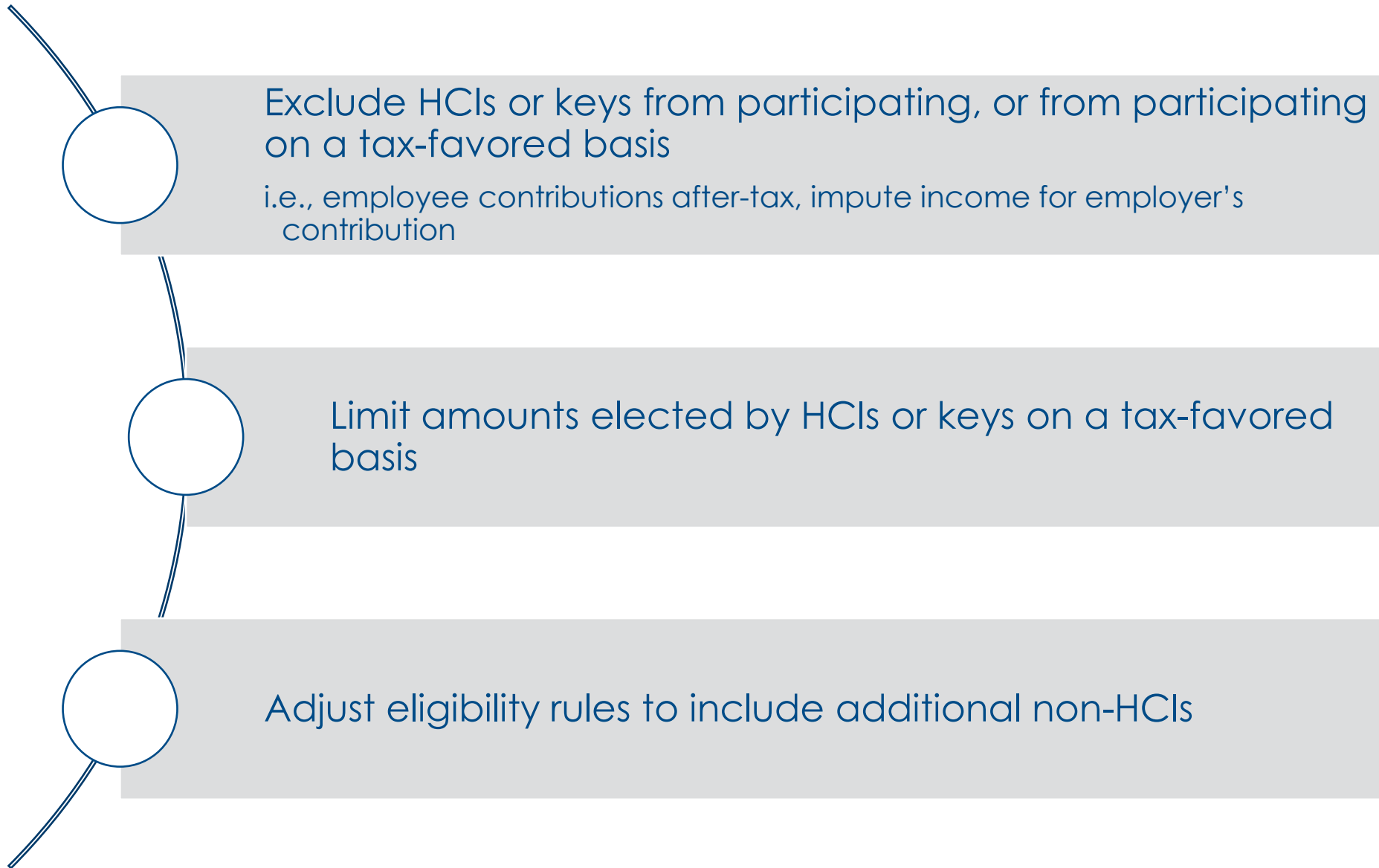
Common Employer Scenarios

- **Differing Waiting Periods** – Salaried employees eligible date of hire; hourly employees eligible 1st of the month following 60 days
- **Differing Eligibility** – Managers are offered a basic and buy-up medical plan; all other full-time employees are offered the basic medical plan
- **Differing Contributions** – Employee contribution decreases with tenure
- Not Discriminatory
 - Employee contribution increases as wages increase (lower paid employees pay less for coverage)
 - Differing benefits or contributions for owners

Consequences for a Discriminatory Plan

- If plan adjustments are not made to bring the plan into compliance before the end of the plan year:
 - IRS could require retroactive taxation of benefits received by highly compensated and key employees
 - Employer may owe retroactive payroll taxes
 - Late penalties may apply for both

Discriminatory Plan Corrections





Questions?
