

Nondiscrimination Rules FAQ

Health Insurance Nondiscrimination Rules

Overview

Group health plans and tax-favored accounts—including health savings accounts (HSAs), health flexible spending arrangements (health FSAs), and health reimbursement arrangements (HRAs)—are subject to numerous nondiscrimination provisions under federal law. The most common nondiscrimination provisions are described below.

General Rules

Employers are generally free to set the eligibility rules for their group health plans, so long as:

- Employees are provided sufficient notice of the rules in accordance with the Employee Retirement Income Security Act and the Affordable Care Act
- The rules do not unlawfully discriminate against certain employees

Section 125 Nondiscrimination Rules for Cafeteria Plans

Health benefits offered as part of a "cafeteria plan"—a plan which meets specific requirements to allow employees to receive certain benefits on a pre-tax basis—are generally subject to the nondiscrimination requirements of Internal Revenue Code section 125.

To satisfy the section 125 nondiscrimination requirements, a plan generally must satisfy three tests:

- **Eligibility Test:** The plan may not discriminate in favor of highly compensated individuals when it comes to eligibility requirements
- **Benefits and Contributions Test:** The plan may not discriminate in favor of highly compensated participants when it comes to benefits and contributions
- **Key Employee Concentration Test:** Nontaxable benefits provided to key employees may not exceed 25% of the nontaxable benefits provided for all employees under the plan.

Safe harbors for satisfying these nondiscrimination tests exist for certain types of cafeteria plans. For more information, please see the 2007 proposed cafeteria plan regulations, **which employers may rely on for guidance pending the issuance of final regulations.**

Highly Compensated Individuals

For purposes of section 125, the term "highly compensated individual" means an individual who is either:

- An officer
- A shareholder owning **more than 5%** of the voting power or value of all classes of the employer's stock
- Highly compensated (generally **\$130,000*** in compensation and, if elected by the employer, in the top-paid 20% of employees) *The 130,000 **limit** for 2020 is used to determine who is a **HCE** for **2021**.
- A spouse or dependent of an individual described in the three bullet points above.

Highly Compensated Participants

For purposes of section 125, the term "highly compensated participant" means a highly compensated individual (see above) who is eligible to participate in the cafeteria plan.

Key Employees

For purposes of section 125, a key employee is generally an employee who is **either** of the following:

- An officer having annual pay of more than **\$185,000**
- An employee who is either of the following:
 - A **5% owner** of the business
 - A **1% owner** of the business whose annual pay is **more than \$150,000**.

Section 105 Nondiscrimination Rules for Self-Insured Plans

The nondiscrimination requirements under a self-insured plan are found in Internal Revenue Code section 105(h) and its corresponding regulations. To satisfy these nondiscrimination requirements, a plan generally must satisfy two tests:

- **Eligibility Test:** The plan must not discriminate in favor of highly compensated individuals when it comes to eligibility requirements
- **Benefits Test:** The benefits provided under the plan must not discriminate in favor of participants who are highly compensated individuals.

Highly Compensated Individuals

For purposes of section 105(h), a "highly compensated individual" is generally an individual who is:

- One of the 5 highest paid officers
- A shareholder who owns **more than 10%** in value of the employer's stock
- Among the highest paid **25%** of all employees.

Eligibility Test

To satisfy the eligibility test under section 105(h), a plan must benefit:

- 70% or more of all employees, or 80% or more of all the employees who are eligible to benefit under the plan if 70% or more of all employees are eligible to benefit under the plan; **or**
- Such employees as qualify under a classification set up by the employer and found by the Internal Revenue Service not to be discriminatory in favor of highly compensated individuals.

Classifications

A classification established by the employer must, based on all the facts and circumstances, **be reasonable and established under objective business criteria** that identify the category of employees who benefit under the plan. Reasonable classifications generally include:

- Specified job categories (full-time vs. part-time)
- Nature of compensation (i.e., salaried or hourly)
- Geographic location
- Similar bona fide business criteria

Permitted Exclusions

The following employees may be excluded from consideration under the eligibility test:

- Employees who have not completed 3 years of service
- Employees who have not attained age 25
- Part-time or seasonal employees
- Employees covered by certain collective bargaining agreements
- Employees who are nonresident aliens whose income did not come from a U.S. source.

Benefits Test

To satisfy the **benefits test** under section 105(h), all benefits provided for participants who are highly compensated individuals **must be provided for all other participants**.

HIPPA Nondiscrimination Rules

Under the Health Insurance Portability and Accountability Act (HIPAA), an individual cannot be denied eligibility for benefits or charged more for coverage because of any health factor. However, distinctions among groups of similarly situated participants in a health plan based on bona fide employment-based classifications consistent with the employer's usual business practice may be permissible.

Prohibited Discrimination Health Factors

Under HIPAA, an individual cannot be denied eligibility for benefits or charged more for coverage because of any health factor. "Health factors" include:

- Health status
- Medical condition, including both physical and mental illnesses
- Claims experience
- Receipt of health care
- Medical history
- Genetic information
- Evidence of insurability
- Disability

Classifications

Under federal regulations, distinctions among groups of similarly situated participants in a health plan based on bona fide employment-based classifications consistent with the employer's usual business practice may be permissible. Examples of classifications that, based on all the relevant facts and circumstances, may be bona fide include:

- Full-time versus part-time status
- Employees working in different geographic locations
- Employees with different dates of hire or lengths of service
- Current employee versus former employee status
- Employees with different occupations
- Employees that are members of collective bargaining units

Nondiscrimination Rules Related to Medicare-Eligible Individuals

Group health plans of employers with 20 or more employees are required by law to offer workers and their spouses who are age 65 (or older) the same health benefits that are provided to younger employees.

In addition, the Medicare Secondary Payer provisions prohibit employers from encouraging or offering incentives to individuals who are eligible for, or already enrolled in, Medicare to elect enrollment in Medicare instead of enrolling in the group health plan (including a self-insured plan) that would otherwise be "primary" to Medicare.

Other Nondiscrimination Rules

It is also important to remember that various federal, state, and local laws prohibit discrimination in the provision of benefits based upon race, color, national origin, sex, age (over 40), or disability.