Employee Benefits
Population Health
Retirement Services

UBA ComplianceAdvisor

WHAT YOU NEED TO KNOW

Benefit Plan Design: Charging Employees Different Premiums

Employers who are designing a health and welfare benefit plan for their employees often wonder about the rules relating to setting premiums for employees. Employers generally have significant flexibility in this part of their plan's design. Common structures contemplated by employers include, but are not limited to:

- Charging all employees a flat amount for their health plan
- Charging employees a percentage of the premium for the health plan, with the percentage changing as employees move between tiers (self, self plus one, self plus family)
- Giving employees a set dollar amount that they can use to offset the cost of whatever plan and plan tier they enroll in

Employers are also interested in setting different contribution structures for different groups of employees. Sometimes this is due to a geographic difference between employees, job types, staff versus management, and more. Employers may wish to give lower-paid employees more employer-provided money; sometimes employers wish to give managers or executive staff more employer-provided money.

Employers should be aware that there are different nondiscrimination requirements to consider.

Generally, under HIPAA non-discrimination rules, employers have discretion when structuring their benefits plans and may make distinctions among employee populations regarding access to and the level of benefits offered. Plans may differ among employees only on "bona fide employment-based classifications" consistent with the employer's usual business practice. Examples that would satisfy this requirement include salaried, hourly, full-time, part-time, type of job, geographic location, date of hire, division, subsidiary, business unit, and profit center distinctions.

If an employer's proposed structure meets these basic HIPAA requirements, then the employer needs to review the applicable nondiscrimination requirements under Internal Revenue Code Section 125 (for cafeteria plans) and Section 105(h) (for self-funded plans). If the employer's plan is subject to these rules, at a most basic level, the plan cannot favor highly compensated individuals. Sometimes an innocent plan design can lead to an employer failing the nondiscrimination requirements under Section 125 or 105(h) without the employer intentionally favoring the highly compensated employees. Many employers also erroneously assume that none of their employees fall into the "highly compensated" category, so the rules do not apply to them. As a best practice, any time an employer has a plan design with different levels of employer contributions, the employer should run the applicable testing to ensure its plan is compliant.

Under Section 125, benefit plans cannot discriminate in favor of highly compensated individuals or key employees.

Highly compensated individuals are defined as:

- Officers
- Five percent shareholders
- Highly compensated employees (HCEs)
- Spouses or dependents of any of the preceding individuals

Key employees are participants who, at any time during the plan year, are one of the following:

- Officers with annual compensation greater than an indexed amount ($175,000 for 2017)
- Five percent owners of the employer
- One percent owners having compensation in excess of $150,000

Under Section 105(h), plans cannot discriminate in favor of highly compensated individuals.

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

- One of the five highest-paid officers
- A shareholder who owns more than 10 percent of the value of stock of the employer's stock
- Among the highest-paid 25 percent of all employees (other than excludable employees who are not participants)

Consequences of Violating HIPAA Nondiscrimination Rules

Violating HIPAA nondiscrimination requirements can trigger numerous potential penalties, including an excise tax penalty of $100 per day per affected plan participant. Employers and plan administrators are expected to self-report these compliance failures using IRS Form 8928.

Historically, enforcement of the filing requirement and collection of the excise tax has been light, but the IRS is now indicating that it expects employers to report failures and pay fines as applicable.

The excise tax is imposed on the plan sponsor, which generally is the employer. In the case of a multiemployer plan, the plan sponsor may be the employee organization, board of trustees, or committee.

Consequences of Failing the Section 125 Nondiscrimination Tests

As a practical matter, the IRS has not recently focused on cafeteria plan nondiscrimination testing. However, if the IRS audits an employer, the employer will need to furnish the results of the required testing and documentation of the employer's corrective actions in response to any failed tests.

Be aware that a plan will not be treated as satisfying the nondiscrimination testing requirements if there are repeated changes to plan testing procedures or plan provisions that have the effect of manipulating the nondiscrimination testing results.

As a reminder, if the plan violates one of the structural requirements of Section 125, then the plan will not be a valid cafeteria plan and no participant will be entitled to favorable tax treatment under Section 125. If the plan fails to satisfy the structural requirements of Section 125 or fails to operate according to its written plan, then each employee's election between taxable and nontaxable benefits results in gross income to the employee.

In contrast, a highly compensated participant or key employee in a discriminatory cafeteria plan must include in gross income the value of the taxable benefit with the greatest value that the employee could have elected to receive, even if the employee elects to receive only the nontaxable benefits offered. This requires both the employer and the affected employees to amend past tax filings to account for undeclared gross income, unpaid Social Security, FICA, FUCA and more.

There are no adverse tax consequences for non-highly compensated participants in a discriminatory cafeteria plan.

Consequences of Failing the Section 105(h) Nondiscrimination Tests

If the plan fails the nondiscrimination tests, then highly compensated individuals' excess reimbursements will be taxable. If the plan is discriminatory, then non-highly compensated individuals will not lose their tax benefits and the plan will not lose its status as a valid Section 105 plan.

Amounts that are excess reimbursement are includable in a highly compensated individual's income; the excess reimbursement calculation varies based on whether the benefits were paid to highly compensated individuals due to either discriminatory coverage for failing to meet the Eligibility Test, or discriminatory benefits for failing to meet the Benefits Test, or both.

Related Advisors:

- HIPAA Nondiscrimination: A Short Course
- Section 105(h) Nondiscrimination Testing
- Nondiscrimination Rules for Cafeteria Plans

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