# Health Insurance Nondiscrimination Rules

This page covers the following topics:



## 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:

1. Employees are provided **sufficient notice of the rules** in accordance with the Employee Retirement Income Security Act (for example, through a summary plan description and/or a summary of material modifications, as applicable) and under the Affordable Care Act (for example, through a summary of benefits and coverage and/or a notice of modification, as applicable); **and**
2. The rules do not **unlawfully discriminate** against certain employees (for example, any limitation on benefits with respect to a working spouse should apply equally to each similarly situated employee's coverage under the plan).

## 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 (Code) Section 125. In addition to traditional group health plans, benefits under a health FSA must be made through a cafeteria plan, and contributions to HSAs may be offered or made through a cafeteria plan.

**Note:** Health FSAs are also subject to the Code Section 105 nondiscrimination requirements described below.

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** as to eligibility to participate; and
- **Benefits and Contributions Test:** The plan may not discriminate in favor of **highly compensated participants** as to benefits and contributions; and

- **Key Employee Concentration Test:** The nontaxable benefits provided to **key employees** may not exceed **25%** of the nontaxable benefits provided for all employees under the cafeteria plan.

**Safe harbors** for satisfying these nondiscrimination tests exist for certain types of cafeteria plans, including premium-only plans (POPs) meeting specific regulatory requirements. 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:

- 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 **$125,000** in compensation and, if elected by the employer, in the top-paid 20% of employees); or
- 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 $180,000**; or
- An employee who is either of the following:
    - A **5% owner** of the business; or
    - A **1% owner** of the business whose annual pay is **more than $150,000**.

**Due to the complexity of testing plans for compliance with the Section 125 nondiscrimination rules, any employer that is considering offering health benefits to only certain classes of employees should carefully review all of the provisions of that section and its accompanying regulations, and seek the advice of a knowledgeable benefits attorney for specific guidance on its particular plan.**

## Section 105 Nondiscrimination Rules for Self-Insured Plans

The nondiscrimination requirements under a self-insured plan—including HRAs and health FSAs (which are also subject to the Section 125 nondiscrimination rules described above)—are found in 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** (as defined below) as to **eligibility to participate**; and
- **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 five highest paid officers;
- A shareholder who owns more than 10% in value of the employer's stock; **or**
- 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 IRS 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 (that is, salaried or hourly);
- Geographic location; and
- Similar bona fide business criteria.

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

- Employees who have not completed three years of service;
- Employees who have not attained age 25;
- Part-time or seasonal employees;
- Employees covered by certain collective bargaining agreements; and
- 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**.

**Due to the complexity of testing plans for compliance with the Section 105(h) nondiscrimination rules, any employer that is considering offering health benefits to only certain classes of employees should carefully review all of the provisions of that section and its accompanying regulations, and seek the advice of a knowledgeable benefits attorney for specific guidance on its particular plan.**

# HIPAA 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.

### Health Factor Discrimination Prohibited

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; or
- Disability.

Click here to read the federal regulations on the health factor discrimination prohibition.

### Bona Fide Employment-Based Classifications May Be Permitted

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; and
- Employees that are members of collective bargaining units.

Employees in different bona fide employment-based classifications can have different eligibility provisions, different benefit restrictions, or different costs, provided the distinction is consistent with the employer's usual business practice. Please note, however, that such distinctions must still comply with other federal and state nondiscrimination laws (for example, waiting periods cannot exceed 90 days under the Affordable Care Act).

## 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. A group health plan is the primary payer when:

- An individual is age **65 or older**, and covered by a group health plan through his or her current employment or his or her spouse's current employment; and
- The employer has **20 or more employees** (or the employer is part of a multi-employer group with at least one employer that employs 20 or more individuals).

### Medicare Premium Reimbursements & Federal Nondiscrimination Laws

According to an informal discussion letter from the U.S. Equal Employment Opportunity Commission (EEOC), giving eligible employees a choice between remaining on employer-provided group health insurance or receiving employer-provided payment of Medicare Part B premiums generally would not constitute an impermissible adverse action against older workers under the Age Discrimination in Employment Act (ADEA) **if it creates an advantageous option available only to them**.

Whether a specific plan provides advantageous options, or imposes an adverse action, is dependent on the facts and circumstances. (Note: Under the specific facts addressed in the letter, employees were also required to provide written acknowledgement that they had reviewed both options and had voluntarily chosen to withdraw from employer-provided group health insurance.)

If the Medicare Part B reimbursement plan were to create an adverse action for older workers, it would be lawful only if it met an ADEA exemption or defense. A further discussion of exemptions and defenses is available in the letter. **The letter is not a formal opinion and does not address Medicare or federal tax issues.**

## 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, sex, age (over 40), and certain other factors.

## Additional Information

- IRS Publication 15-B, *Employer's Tax Guide to Fringe Benefits*
- IRS Publication 969, *Health Savings Accounts and Other Tax-Favored Health Plans*