
Welcome! We will begin at 3:00 ET.

There will be no sound until we begin the webinar.

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2023

Benefit Nondiscrimination Rules

Presented by Benefit Comply

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Agenda

- Benefit Nondiscrimination Rules - Overview
- Discrimination Testing
- Corrections & Penalties

Common Question: Can the employer differ _____ between classes of employees? Isn't that discriminatory?

Answer: 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)

BUT for benefits provided on a tax-favored basis...

Benefit Nondiscrimination Rules - Overview

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

Benefit Nondiscrimination Rules

§125
Cafeteria Plan
Benefits

§105(h)
Self-Funded
Group Health
Plans

§129
Dependent Care
Account Plans
(DCAPs)

§79
Life Insurance

Examples

Fully-insured medical, dental, vision, life, health FSA, HSA and DCAP offered through a cafeteria plan

- Aggregated benefits are subject to §125 rules
- Life insurance is subject to §79
- Health FSA is subject to §105(h) rules
- DCAP is subject to §129 rules

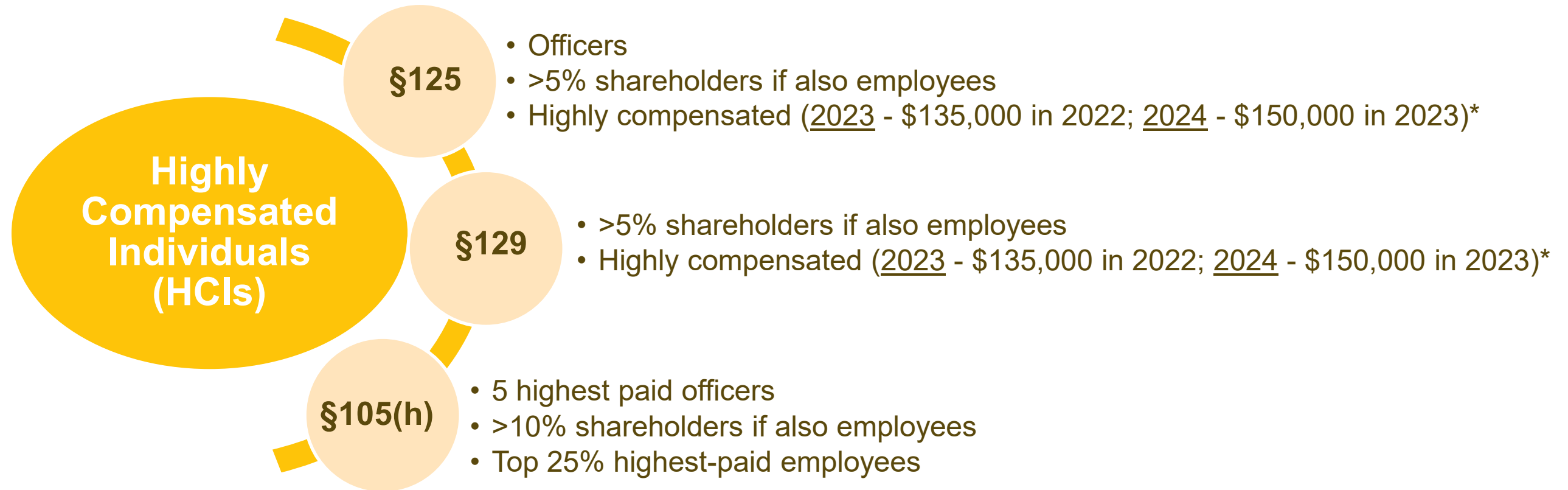
Fully-insured medical, dental and vision offered through a cafeteria plan + an HRA

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

HSA

- Not Run Through Employer's Cafeteria Plan
 - Subject to comparability rules, which generally require uniform employer HSA contributions by tier of coverage
- Run Through Employer's Cafeteria Plan (More Common)
 - Not subject to any nondiscrimination rules on its own, but aggregated with other benefits run through the employer's cafeteria plan for purposes §125 discrimination testing

Highly Compensated Individuals (HCIs)



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

Highly Compensated Individuals (HCIs)

Example 1: 300 employees who all earn \$115,000 or less

- No HCIs other than any officers or shareholder employees under §125 and §129
- Top 25% highest paid are HCIs under §105(h)

Example 2: 300 employees, all of whom earn > \$150,000

- All are HCIs under §125 and §129 unless top-paid election is made (top-paid 20% are then HCIs)
- Top 25% highest paid are HCIs under §105(h)

Key Employees

- §125 and §79
 - Officers with annual compensation in excess of
 - 2023 - \$200,000 in 2022
 - 2024 - \$215,000 in 2023
 - >5% owners if also employees
 - >1% owners with annual compensation in excess of \$150,000

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

Discrimination Testing

§125

§105(h)

§129

§79

Eligibility Test

Contributions & Benefits Test

Key Employee Concentration Test

Eligibility Test

Benefits Test

Eligibility Test

Contributions & Benefits Test

More Than 5% Owners Concentration Test

55% Average Benefits Test

Eligibility Test

Benefits Test

Discrimination Testing

- Data Required for Discrimination Testing
 - Employee census (all employees)
 - Must include related employers through a controlled group or affiliated service group
 - Annual compensation for all employees and designate any officers
 - Benefit offerings
 - For purposes of §125 testing, include all benefits run through the employer's cafeteria plan
 - Benefit eligibility for all employees
 - Actual participation by employees

§125 Testing (3 Tests) – Cafeteria Plans

Eligibility Test

Cannot discriminate as to eligibility to participate

- Are enough non-HCIs eligible to participate in the cafeteria plan?

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

***For a premium only plan (POP), only necessary to pass the eligibility test

§125 Eligibility Test

- Consider all employees except:
 - Employees covered by a collectively bargained plan ;
 - Nonresident aliens with no U.S. source income; and
 - Employees participating in the cafeteria plan as COBRA participants
- Testing is numbers-based
 - Consider eligible non-HCIs/total non-HCIs against eligible HCIs/total HCIs
 - Ratio result must meet a certain percentage
 - Percentage that must be met depends on employer's total number of employees and number of HCIs versus non-HCIs

§125 Contributions & Benefits Test

- Availability - Subjective
 - All similarly situated employees must get the same employer contribution OR have a uniform opportunity to elect benefits
- Utilization - Mathematical
 - Consider benefits elected by HCs/HCs' compensation against benefits elected by non-HCs/non-HCs' compensation
 - Percentage for HCs must be less than percentage for non-HCs

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 – Employer contribution increases with tenure

Common Employer Scenarios

- Not Discriminatory
 - Employee contribution increases as wages increase (lower paid pay less)
 - Differing benefits or contributions for owners

Corrections & Penalties

Discriminatory Plan Corrections

Exclude HCs or key employees from participating, or from participating on a tax-favored basis

Limit amounts elected by HCs or key employees on a tax-favored basis

Adjust eligibility rules to include additional non-HCs or encourage more non-HCs to participate

Consequences for a Discriminatory Plan

- If plan adjustments are not 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

2023

Thank You. Questions?