Non-Discrimination Testing

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What is Non-Discrimination Testing?

• Ensure that plans do not discriminate in favor of highly compensated employees, officers, key employees or owners.

• Each code section (plan) has its own testing requirements and definitions.
IRS Requirements

- Testing each plan year
- Test results are not sent to the IRS, but may be requested in an audit
- Fines associated with failure to test
- Failure of a test results in taxation penalties
Definitions

• Key Employee
  ▫ Officer of the employer with annual compensation in excess of $170,000
  ▫ More than 5% owner of the employer
  ▫ More than 1% owner with annual comp in excess of $150,000

• Highly Compensated Individuals (HCI)
  ▫ One of the 5 highest paid officers
  ▫ A shareholder who owns more than 105% of the value of stock
  ▫ Among the highest 25% of all employees

• Highly Compensated Employees (HCE)
  ▫ More than a 5% owner
    • Attribution rules include employees spouses, parents, children and grandchildren
  ▫ Preceding plan year compensation in excess of $120,000
What plans are subject to NDT?

Cafeteria Plans

Group Life

DCAP

Self Funded Medical

FSA

Coming Soon:

Fully Insured Medical

HSA

HRA
Cafeteria Plan Test

- Eligibility Test
  - Checks if a reasonable number of non-highly compensated *individuals* are eligible to participate in plan.
- Testing Requirements
  - Employment Requirement
  - Entry Requirement
  - Nondiscriminatory Classification Requirement
Cafeteria Plan Test

- Contributions & Benefits Test
  - Plan may not discriminate in favor of highly compensated participants *(HCI who is eligible to participate in Cafeteria plan).*
  - Testing Requirements
    - Availability
    - Utilization
    - Non-discrimination in Operation
  - Safe Harbor Rule
    - Major Medical Coverage
    - 100% or 75%
    - Excess Contributions
Cafeteria Plan Test

• Key Employee Concentration Test
  ▫ Key employee contributions cannot exceed 25% of the total contributions.

• Safe Harbors & Exceptions
  ▫ Collectively Bargained Plans
  ▫ Premium-Only Plans
  ▫ Simple Cafeteria Plans

So What if I fail?
  - Expand eligibility
  - Hire less seasonal/PT
  - Increase participation
  - Avoid 100% ER paid single
  - Adjust owners/officers
  - Decrease eligibility
Health Savings Account (HSA) Test

- Testing your HSA through your cafeteria plan follows the section 125 non-discrimination rules (eligibility, contributions & benefits, key employee concentration test)
- Comparability Rules
  - HSA deposits made outside the section 125, or direct employer contributions.
  - Equal dollar amount or percentage of deductible
    - FT/PT
    - Family Status
    - HSA eligible
Dependent Care Account (DCA) Tests

• Eligibility Test
  ▫ Ensures that a reasonable percentage of non-highly compensated employees are eligible to participate

• Contributions & Benefits Test
  ▫ Requires that the benefits and contributions do not favor highly compensated employees
Dependent Care Account (DCA) Tests

• 55% Average Benefit Test
  ▫ Requires the average DCA benefit for non-highly compensated employees to be at least 55% of the average DCA benefit for highly compensated employees

• More-Than-5% Owners Concentration Test
  ▫ Participants who are more than 5% shareholders and have a DCA cannot receive more than 25% of the plans total DCA benefit

So What if I fail?
- Expand eligibility
- Hire less seasonal/PT
- Owners/HCI’s don’t participate or max limited
Health FSA Testing

- **Eligibility Tests**
  - Ensures that the plan does not discriminate in favor of highly compensated individuals
  - 70% Test
  - 70% / 80% Test
  - Non-Discriminatory Classification
    - Reasonable Classification
    - Non-discriminatory classification

- **Benefits Test**
  - Required employee contributions same for each benefit level
  - Max benefit level cannot vary based on age, years of service or comp.
  - Same benefits
  - Different waiting periods cannot be imposed

**So What if I fail?**
- Increase participation among lower-paid
- Decrease participation among higher-paid
  - Limit eligibility to only FT
  - Offer an employer contribution
    - Same waiting periods
    - Same maximum election
HRA & Self-Insured Medical Tests

- Eligibility Tests
  - 70% Test
  - 70% / 80% Test
  - Non-Discriminatory Classification Test
    - Reasonable Classification
    - Non-discriminatory classification

- Benefits Test
  - Non-Discriminatory on its face
  - Non-Discriminatory in operation of the plan
Fully Insured Plan Tests

• Proposed Regulations
  ▫ Earliest Adoption 1/1/17
• Eligibility Test
• Benefits Test
• Penalty is different
  ▫ Self Insured – taxable income equal to the value of excess benefits for HCI’s
  ▫ Insured plans - $100 per day per non- HCE who is discriminated against. Max $500k/yr
Group Life Testing

- Plan may not discriminate in favor of key employees with respect to eligibility or benefits

- Tests:
  - Plan must benefit 70% or more of all employees
  - At least 85% of all participants in the plan are non-key employees
  - Plan benefits employees defined by a classification found by the IRS not to be discriminatory
  - Plan is part of a cafeteria plan
**Excludable Employees**

- Possible exclusions, based upon plan
  - Less than 3 years service
  - Under 25 Years Old
  - Part-time & Seasonal
  - COBRA Employees
  - Covered under a collective bargaining agreement
  - Non-resident alien with no US source income
In Conclusion

• Test annually
• Accurate data
• Small plans create the most problems, might be best to exclude your highly compensated from the plan
• Complicated plan designs with different entry dates or different benefits can cause problems

Keep It Simple!