For various reasons, employers may wish to exclude certain classes of employees from group health plan coverage or offer different benefits or contributions to different classes of employees (e.g., managerial vs. non-managerial). These arrangements, sometimes referred to as "carve-outs" or "classing out," need to be analyzed under several laws to determine whether such treatment would be permissible. The following provides a summary of key nondiscrimination requirements that may apply to employer-sponsored health plans under federal law. (Be sure to check your state law as additional rules may apply.)

Due to the complexity of the law in this area, any employer that is considering offering health benefits to only certain classes of employees (or offering different benefits or contributions to different groups of employees) should consult a knowledgeable benefits attorney or specialist for guidance regarding its plan(s) and the specific nondiscrimination tests that may apply.

1. ACA Nondiscrimination Requirements

The Affordable Care Act (ACA) nondiscrimination rules are delayed until further notice. Any penalties for failure to comply will not apply until after further guidance is issued, following a grace period to allow plan sponsors time to implement any changes. Prior to this delay, the ACA required non-grandfathered fully insured group health plans to satisfy the IRS requirements prohibiting discrimination in favor of highly compensated individuals that currently apply to self-insured plans.

Although fully insured plans are not currently subject to the ACA nondiscrimination requirements, 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) generally will be subject to the nondiscrimination requirements of Internal Revenue Code § 125.

Note: Large employers subject to the ACA's "pay or play" requirements may be subject to a penalty if they do not offer affordable health insurance that provides minimum value to all full-time employees (and their dependents). Small employers who wish to participate in the Small Business Health Options Program (SHOP) must offer coverage to all full-time employees (states may impose additional requirements). To take advantage of the small business health care tax credit, an employer must pay at least 50% of the premium cost for single health care coverage for each employee (among other requirements).
2. IRS Nondiscrimination Requirements

The value of accident or health benefits provided under an employer-sponsored plan is generally excluded from an employee's wages. However, if the plan favors certain key employees or highly compensated individuals, it may be considered discriminatory, which means the favorable tax treatment may not apply to those individuals and they will need to include such amounts in income.

The following is a summary of the key IRS nondiscrimination rules that may apply (note that, depending on the type of plan, more than one test may need to be satisfied):

**CAFETERIA PLANS – Section 125**

A "cafeteria plan" is a plan which meets specific requirements to allow employees to receive certain benefits on a pre-tax basis. Health flexible spending arrangements (health FSAs) are one form of cafeteria plan benefit. Contributions to health savings accounts (HSAs) may also be made through a cafeteria plan.

- **Eligibility:** The plan may not discriminate in favor of highly compensated individuals as to eligibility to participate; and
- **Benefits and Contributions:** The plan may not discriminate in favor of highly compensated participants as to contributions and benefits; and
- **Key Employee Concentration:** 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 the nondiscrimination rules may exist for certain cafeteria plans (such as premium-only plans and simple cafeteria plans meeting specific requirements under the law).

Additional testing may apply depending on the types of benefits offered under the cafeteria plan.

**SELF-INSURED MEDICAL REIMBURSEMENT PLANS – Section 105(h)**

A "self-insured medical reimbursement plan" is an employer plan that reimburses employees for medical expenses not covered by an accident or health insurance policy. Health FSAs—which must be provided through a cafeteria plan under Health Care Reform—and health reimbursement arrangements (HRAs) are generally considered self-insured medical reimbursement plans.
Group Health Plan Nondiscrimination Rules

Eligibility Test: The plan must not discriminate in favor of highly compensated individuals as to eligibility to participate. This means the plan generally 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
- A reasonable classification of employees established under objective business criteria that does not discriminate in favor of highly compensated individuals, as determined by the IRS. (Reasonable classifications may include specified job categories, nature of compensation (salaried/hourly), geographic location, and similar bona fide business criteria that do not discriminate in favor of highly compensated individuals.)

Certain employees may be excluded from consideration in determining eligibility, including those:

- Who have not completed 3 years of service;
- Who have not attained age 25; or
- Who are part-time or seasonal employees.

Benefits Test: In addition to the eligibility requirements, the benefits provided under the plan must not discriminate in favor of participants who are highly compensated individuals. This means all benefits provided for participants who are highly compensated individuals are provided for all other participants.

3. ERISA Nondiscrimination Requirements

Employers are generally free to set the eligibility rules for their group sponsored health plans under the Employee Retirement Income Security Act (ERISA), so long as employees are provided sufficient notice of the rules and the rules do not unlawfully discriminate against certain employees.

Distinctions Based On Health Factors Are Generally Prohibited: 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.

Bona-Fide Employment-Based Classifications May Be Permitted: Distinctions among groups of similarly situated participants in a health plan must be based on bona-fide employment-based classifications consistent with the employer's usual business practice.
Whether an employment-based classification is bona fide is determined on the basis of all the relevant facts and circumstances, including whether the employer uses the classification for purposes independent of qualification for health coverage (for example, determining eligibility for other employee benefits or determining other terms of employment).

Examples of classifications that, based on all the relevant facts and circumstances, may be bona fide include:

- Full-time versus part-time status
- Membership in a collective bargaining unit
- Different occupations
- Different geographic location
- Date of hire or length of service
- Current versus former employee status

### 4. Employment Nondiscrimination Laws

**Federal law** prohibits [covered employers](#) from discriminating with respect to benefits and other privileges of employment, based on the following factors:

- Race
- Sex
- Disability
- Color
- National origin
- Genetic information
- Religion
- Age (40 or older)

Many states also have laws prohibiting discrimination based on these classifications (as well as other protected classes) and may cover employers of all sizes. To avoid the potential for claims of unlawful employment discrimination, eligibility requirements for participation in a group health plan should be applied equally to employees, and plans should make sure that similarly situated employees are treated the same.