



Summary of Group Plan Nondiscrimination Rules

This chart summarizes the basic nondiscrimination rules for cafeteria plans and group health plans.

This chart is provided for general information only and summarizes the basic nondiscrimination rules for cafeteria plans and group health plans. It is not meant to be all inclusive.

Self-funded (self-insured) plans must comply with existing nondiscrimination rules under Internal Revenue Code § 105(h).

Note: In the future, the Affordable Care Act may add rules similar to I.R.C. § 105(h) to non-grandfathered insured plans. This item has been delayed pending the release of IRS regulations.

Additionally, any group health plan—whether insured or self-insured—that is offered through a pre-tax cafeteria plan must comply with existing nondiscrimination rules under I.R.C. § 125.

The IRS regulates and enforces the nondiscrimination rules and may conduct plan audits. IRS regulations set forth rules and testing requirements for employers to ensure compliance.

Employers are encouraged to review their plans with legal counsel and tax advisors that offer nondiscrimination testing services for benefit plans.

§ 125 Cafeteria Plan Rules		§ 105(h) Health Plan Rules	
Definitions	<p>A highly compensated individual (HCI) is:</p> <ul style="list-style-type: none">• An officer of the company;• A more-than-5% shareholder;• An employee paid more than \$155,000 in 2024 or \$160,000 in 2025; or• A spouse/dependent of any of the above. <p>A key employee is:</p> <ul style="list-style-type: none">• An officer paid more than \$220,000 in 2024 or \$230,000 in 2025;• An employee who is either: (a) a more-than-5% owner of the business or (b) a more-than-1% owner paid more than \$155,000 in 2024 or \$160,000 in 2025; or• A spouse/relative of any of the above. <p>Note: Non-employees (e.g., more-than-2% shareholders of an S-Corp, partners in LLPs, members of LLCs, and their spouses/relatives) are prohibited from participating in a cafeteria plan.</p> <p>Related employers (controlled groups and affiliated service groups) are combined under the nondiscrimination rules.</p>	A highly compensated individual (HCI) is: <ul style="list-style-type: none">• One of the five highest-paid officers;• A more-than-10% shareholder; or• One of the highest-paid 25% of all employees. <p>Note: Non-employees (e.g., more-than-2% shareholders of an S-Corp, partners in LLPs, members of LLCs, and their spouses/relatives) can usually participate in health plans only on an after-tax basis. Refer to legal counsel for details.</p> <p>Related employers (controlled groups and affiliated service groups) are combined under the nondiscrimination rules.</p>	
	<p>Nondiscrimination Rules</p> <p>Generally, the nondiscrimination rules for cafeteria plans:</p> <ul style="list-style-type: none">• Require the plan to benefit a class of employees that does not discriminate in favor of HCIs;• Prohibit discriminating in favor of HCIs with respect to benefits and contributions; and• Limit the nontaxable benefits provided to key employees to no more than 25% of the total nontaxable benefits. <p>A “premium only plan” usually avoids the need for complex testing under an IRS safe harbor provision. Special relief also is offered for small employer plans (see Simple Cafeteria Plans).</p>		

§ 125 Cafeteria Plan Rules

Nondiscrimination Tests

Eligibility Test

Tests whether the cafeteria plan is offered on a nondiscriminatory basis by looking at the following:

- Waiting period does not exceed three years and the same waiting period applies to HCLs and non-HCLs;
- Entry into the plan is not delayed (if any required waiting period is met); and
- Benefit a classification of employees that does not discriminate in favor of HCLs. The classification must be based upon a bona fide employment classification consistent with the employer's usual business practice.

Examples: Full-time versus part-time status, current versus former employee status, different geographic location, occupation type, date of hire, and length of service.

Note: This classification must also be considered nondiscriminatory based on a certain safe harbor percentage rate determined in IRS regulations. If using this test, consult with legal counsel first.

Contributions and Benefits Test

Tests for the following:

- Employer contributions and benefits are available on a nondiscriminatory basis;
- Benefits are not elected disproportionately by HCLs; and
- Plan is nondiscriminatory on its face and in operation.

Concentration Test

Tests whether the cafeteria plan benefits key employees disproportionately. Plan will fail the test if the nontaxable benefits provided to key employees exceed 25% of the total nontaxable benefits provided under the plan.

Additional Tests

Additional tests are required for cafeteria plans that include a health flexible spending account (HFSA) and/or a dependent care account (DCFSA). An HFSA, a type of self-funded health plan, is subject to nondiscrimination rules under I.R.C. § 105(h). A DCFSA also is subject to nondiscrimination rules under I.R.C. § 129.

Excludable Employees

Certain employees may be excluded from nondiscrimination testing if they also are excluded from the cafeteria plan:

- Employees with fewer than three years of service; and
- Employees (except key employees) covered by a collective bargaining agreement.

Employees with no U.S. source of income and COBRA participants are not included for testing. Nondiscrimination testing can be done at any time during the plan year and must be performed as of the last day of the plan year, including all former employees who were employees on any day during the plan year.

§ 105(h) Health Plan Rules

Eligibility Test

The self-insured health plan must satisfy any one of the following three tests:

- Benefit 70% or more of all non-excludable employees;
- Benefit 80% or more of eligible employees if 70% or more of all non-excludable employees are eligible; or
- Benefit a classification of employees that does not discriminate in favor of HCLs. The classification must be based upon a bona fide employment classification consistent with the employer's usual business practice.

Examples: Full-time versus part-time status, current versus former employee status, different geographic location, occupation type, date of hire, and length of service.

Note: This classification must also be considered nondiscriminatory based on a certain safe harbor percentage rate determined in IRS regulations. If using this test, consult with legal counsel first.

Benefits Test

Tests whether the self-insured health plan is nondiscriminatory on its face and in operation and looks at the following criteria:

- Required employee contribution levels are the same for HCLs and non-HCLs for each benefit level;
- Maximum benefit level (e.g., employer contribution) does not vary based on age, years of service, or compensation;
- Same type of medical expenses are reimbursable for HCLs and non-HCLs; and
- Eligibility waiting periods are uniform for HCLs and non-HCLs.

Excludable Employees

Certain employees may be excluded from nondiscrimination testing if they also are excluded under the health plan:

- Employees with fewer than three years of service;
- Employees who have not attained age 25;
- Part-time employees (generally defined as those working fewer than 35 hours/week if others regularly work 40 hours/week);
- Employees covered by a collective bargaining agreement; and
- Nonresident aliens with no U.S. source income.

§ 125 Cafeteria Plan Rules

Noncompliance Consequences

If the plan fails the nondiscrimination tests, HCLs and key employees may lose the favorable tax treatment of the plan. The value of the taxable benefits will be included in the HCL's (or key employee's) gross income for tax purposes.

The plan continues to be valid as a pre-tax cafeteria plan. Employees who are not HCLs or key employees are not affected by the failure to pass the nondiscrimination tests.

References

[26 U.S.C. § 125 - Cafeteria plans](#)

[IRS Publication 15-B Regarding Cafeteria Plans](#)

§ 105(h) Health Plan Rules

Self-insured plans (effective now): Amounts considered to be discriminatory benefits ("excess reimbursements") are included in the HCL's gross income for tax purposes. Non-HCLs are not affected.

Proposed penalty for nongrandfathered insured plans (effective date TBD): No HCL penalty. Penalties are imposed on the employer and may include an excise tax and a civil penalty assessed on a per-day, per-individual basis for each instance of discrimination, as well as the possibility of civil action. The excise tax is subject to a cap based on a percentage of the employer's prior year health plan costs or a specified maximum amount, whichever is lower.

[26 U.S.C. § 105 - Amounts received under accident and health plans](#)

Simple Cafeteria Plans

The Affordable Care Act created a simpler plan for eligible smaller employers meeting contribution requirements and eligibility and participation requirements. A simple cafeteria plan is treated as meeting the nondiscrimination requirements of § 125 for cafeteria plans.

Eligibility

For employers with an average of 100 or fewer employees during either of the two preceding years, or if the business was not in existence throughout the preceding year, the employer is eligible if it reasonably expects to employ an average of 100 or fewer employees in the current year. Also, if a simple cafeteria plan is established in a year in which an average of 100 or fewer employees are employed, the employer remains eligible for subsequent years as long as it does not employ an average of 200 or more employees.

Participation

All employees who had at least 1,000 hours of service for the preceding plan year are eligible to participate and each employee eligible to participate in the plan may elect any benefit available under the plan.

Employers may elect to exclude employees who:

- Are under age 21 before the close of the plan year;
- Have less than one year of service as of any day during the plan year;
- Are covered under a collective bargaining agreement; or
- Are nonresident aliens working outside the United States whose income did not come from a U.S. source.

Contribution Requirements

Employers must make a contribution to provide qualified benefits on behalf of each qualified employee in an amount equal to:

1. A uniform percentage (not less than 2%) of the employee's compensation for the plan year; or
2. An amount which is at least 6% of the employee's compensation for the plan year or twice the amount of the salary reduction contributions of each qualified employee, whichever is less.

If the contribution requirements are met using option 2, the rate of contribution to any salary reduction contribution of a highly compensated or key employee cannot be greater than the rate of contribution to any other employee.