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Group Benefits Testing Overview: There's Still Time for 2019

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As we approach the end of the calendar year, many HR staffs are working diligently on open enrollment, but there are some pesky IRS rules that may get overlooked in this busy time of year. Yes, we mean the rules regarding nondiscrimination testing. There are several required health and welfare plan nondiscrimination tests contained in the Internal Revenue Code.

Each of the tests pertains to different benefits and has slightly different aims. In general, all are designed to ensure employer sponsored health and welfare plans are nondiscriminatory in the value of the benefits and in determining who is eligible for the benefits. The aim is to prevent employers from favoring highly compensated employees, key employees and 5% or more owners with more access to benefits or with richer benefits. If plans are tested after the end of the plan year, it is called a retrospective test. If you test plans prior to the plan year-end, it is considered a prospective test. While it's always better to conduct these tests earlier in the year, there's still time to identify issues prospectively for 2019 calendar year plans and make corrections.

Section 125 Testing

Who should test? Any plan sponsor of cafeteria plans (e.g. pre-tax benefits to employees for things like insurance premiums, healthcare expenses, dependent care expenses and even adoption fees) should test.

What happens if my plan fails? If the test is done retrospectively, you may need to re-characterize the "discriminatory benefits" as taxable benefits or the plan risks losing its tax-favored status. If the test is done prospectively, you can often make corrections in time to avoid that outcome.

Section 105(h) Testing

Who should test? Any plan sponsor of a self-funded health benefit plan, which can include a medical/prescription drug plan, dental benefits plan, healthcare flexible spending accounts (FSAs) or even stand-alone health reimbursement arrangements (HRAs), should test.

What happens if my plan fails? If the test is done retrospectively, you may need to re-characterize any "excess reimbursements" as taxable income. The plan keeps its tax-favored status and the non-highly compensated employees in the plan are not affected. If

the test is done prospectively, you can often make corrections in time to avoid failures.

Section 129 Testing

Who should test? Any plan sponsor of a dependent care FSA plan should test.

What happens if my plan fails? If the test is done during the year and the failure is caught early enough, an employer can quickly make changes, communicate those changes to affected employees and avoid any issue. If done retrospectively, you may need to re-characterize the "excess reimbursements" from their dependent care FSA as taxable benefits and re-issue W2s. If you have a FSA plan, you may already have had Section 129 testing conducted on your behalf, but now is the time to check in on those results. *Note this plan is the most commonly failed because of its unique utilization requirements.*

Section 79 Testing

Who should test? Any plan sponsor of a group term life plan should test.

What happens if my plan fails? If the test is done during the year and the failure is caught early enough, an employer can quickly make changes, communicate those changes to affected employees and avoid any issue. If done retrospectively, key employees will lose the income tax exclusion of the first \$50,000 of life insurance coverage. They will have to include in their income the greater of the actual cost of all of their employer-provided coverage or the rates for that coverage that are provided in Code Section 79. Non-key employees are not affected by the failure.

Section 137 Testing

Who should test? Any plan sponsor of an adoption assistance program, which provides a limited income tax exclusion (\$14,080 in 2019) for employer-provided adoption assistance, should test.

What happens if my plan fails? If the test is done during the year and the failure is caught early enough, an employer can quickly make changes; communicate those changes to affected highly compensated employees and owners of 5% or more of the employer's stock, capital or profit interest. If the test is done retrospectively, you may need to re-characterize the

“discriminatory benefits” as taxable benefits or the plan risks losing its tax-favored status, and all plan participants lose the income tax exclusion.

Section 127 Testing

Who should test? Any plan sponsor of an educational assistance program, which provides a limited income tax exclusion (\$5,250) for the employer’s payment certain educational expenses, should test.

What happens if my plan fails? If the test is done during the year and the failure is caught early enough, an employer can quickly make changes; communicate those changes to affected highly compensated employees and owners of 5% or more of the employer’s stock, capital or profit interest. If the test is done retrospectively, you may need to re-characterize the “discriminatory benefits” as taxable benefits or the plan risks losing its tax-favored status, and all plan participants lose the income tax exclusion.

As in dealing with most IRS laws and regulations, it’s important to have a trusted advisor. Please reach out to

your Findley consultant or whomever you’ve outsourced the administration of your health and welfare plans. Make sure your plans have been tested for 2019. Better yet, check your plan designs before the 2020 testing year begins to assess the likelihood of passing the required nondiscrimination tests.

Questions regarding how to develop an innovative HR strategy or assess your current HR function or talent, contact the Findley consultant you normally work with, or Dave Tighe at Dave.Tighe@findley.com, 419.327.4149, or Sheila Ninneman at Sheila.Ninneman@findley.com, 216.875.1927.

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