



# eBenefits Alert: Compliance Considerations with Regard to the Minnesota Section 125 Plan Requirement Going Into Effect July 1, 2009

June 3, 2009

Effective July 1, 2009, Minn. Stat. 62U.07 will require all Minnesota employers who have 11 or more full-time equivalent employees and who do not already offer a group coverage health plan to their employees to either:

- (a) Establish and maintain a Section 125 Plan to allow their employees to purchase individual market or employer-based health coverage with pretax dollars; or
- (b) Opt out of the requirement to establish a Section 125 Plan by completing and sending an "opt-out" form to the commissioner of commerce. That form can be found at the following Web site link: <http://www.commerce.state.mn.us/Section125/Section125.html>

The Section 125 Plan requirement does not apply to employers who already offer health coverage or who have no employees who are eligible to participate in a Section 125 Plan. Consequently, while the law applies broadly, many employers will be exempt from its requirements. The law does not require any employer to offer or purchase group health coverage for their employees.

Although Section 125 Plans (also referred to as "cafeteria plans") can offer a variety of features, the type of Section 125 Plan that the Minnesota law requires only has one feature: it allows employees to pay for health care coverage on a pre-tax basis. These types of plans are commonly referred to as "premium-only plans" or "POPs." Under a premium-only plan, employees are permitted to elect to have amounts withheld from their pay which are then used to pay for health care coverage on the employee's behalf.

## **Requirements of a 125 Plan**

Premium-only Section 125 Plans must comply with rules found under Code Section 125 of the Internal Revenue Code. Among other things, the IRS requires that a Section 125 Plan:

- Be written down and formally adopted by the employer. The plan document must contain certain information about the plan such as who is eligible to participate, election procedures, etc.



- Meet certain nondiscrimination requirements, which prohibit the plan from discriminating in favor of highly-compensated employees.

All Section 125 Plans should be reviewed by a professional benefits practitioner before adoption to ensure compliance with all applicable rules.

### **Benefits of Adopting a "Premium-only" Section 125 Plan**

Employers who adopt a premium-only Section 125 Plan provide a tax benefit to their employees as well as to themselves. This is because employees do not pay federal or state income tax on the amounts used to pay insurance premiums. In addition, both employees and employers do not pay FICA or FUTA on these amounts. Certain small employers can receive grants of \$350 to offset the cost of establishing a Section 125 Plan.

### **However, Employers Should Use Caution...**

Despite the positive features of premium-only plans, employers should nonetheless use caution and consult with experienced benefits practitioners before deciding whether to adopt one. There are at least two major concerns with regard to premium-only Section 125 Plans that employers should consider:

#### *Premium-only Plans May be Subject to ERISA*

Most benefit plans that offer health care benefits to employees are subject to reporting, disclosure and other requirements of the Employee Retirement Income Security Act (ERISA). However, because under a premium-only Section 125 Plan, the employer merely acts as a conduit to provide pre-tax payment of individual policies, the Department of Labor has determined that by itself a premium-only Section 125 Plan is not subject to ERISA. This unique exception to the federal law generally exempts employers who adopt such plans from ERISA requirements, saving both time and compliance costs.

Employers should be aware that this "safe-harbor" exemption from ERISA only applies if the employer does not establish or maintain the plan. When the employer acts only as a conduit, but does not actively manage or promote the health plan, the plan can remain exempt from ERISA's requirements. However, if the employer takes a more active role, for example by making contributions for employee health benefits or by actively promoting and endorsing particular insurance policies, the safe-harbor exemption from ERISA may no longer apply.

#### *HIPAA Considerations*

Another potentially concerning issue is whether creation of a premium-only Section 125 Plan creates a "group health plan" for purposes of Health Insurance Portability and Accountability Act (HIPAA). HIPAA, among other things, prohibits "group health plans" from discriminating against individuals based on health



status. Employers who actively maintain a group health plan are already subject to these nondiscrimination rules, thus the addition of a Section 125 Plan generally does not pose any significant risk of HIPAA violations. Under a premium-only Section 125 Plan, however, individuals are permitted to choose from any number of individual policies, generally individually underwritten, from various insurance companies. Because Minnesota state law with regard to individual insurance products is less stringent than HIPAA requires for "group health plans," it is unlikely that individual insurance products will satisfy HIPAA nondiscrimination standards. Thus, employers who allow employees to use their premium-only Section 125 Plan to pay for individual insurance products that do not comply with HIPAA may inadvertently subject themselves to the risk of penalties for noncompliance.

Informal comments from the Internal Revenue Service indicate that it is concerned with these types of premium only arrangements for individual policies because allowing these types of plans to escape HIPAA requirements could encourage employers to drop group health plans and instead adopt premium-only Section 125 Plans.

#### **What should employers do?**

Minnesota employers have several options:

1. Adopt or continue maintaining a HIPAA and ERISA-compliant group health plan.
2. Consult with an experienced benefits practitioner to design a Section 125 Plan that will comply with the Minnesota state requirements, keeping in mind ERISA and HIPAA concerns.
3. Opt out of the Minnesota cafeteria plan requirement using the following Web site link: <http://www.commerce.state.mn.us/Section125/Section125.html>

For a more detailed explanation of the Minnesota Section 125 Plan law, or for assistance in drafting or reviewing Section 125 Plan documents, you may contact Gray Plant Mooty attorneys Kathi Wright or Brita de Malignon or any of the other experienced benefits attorneys in our Employee Benefits and Executive Compensation practice group.

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