

exclusion under section 105(d), as provided in paragraph (a) of this section.

(2) The Commissioner may prescribe a form and instructions with respect to the agreement provided for in paragraph (a)(4) of this section.

(c) *Employer certification*—(1) *Advance approval of procedures*. Any reasonable and consistently applied procedures, approved in advance by the Internal Revenue Service, which require the employee to provide the employer or the insurer with medical documentation sufficient to show that an illness or disability existed as of the date of the employee's retirement, which would have entitled him to retire on account of personal injuries or sickness alone, are sufficient for purposes of this paragraph.

(2) *Place of submission*. Request for advance approval of procedures for certification shall be submitted to the district director.

(d) *Cross reference*. For special rules pertaining to taxpayers retired on disability before January 27, 1975, see § 1.72-15(i).

[T.D. 7352, 40 FR 16666, Apr. 14, 1975]

§ 1.105-11 Self-insured medical reimbursement plan.

(a) *In general*. Under section 105(a), amounts received by an employee through a self-insured medical reimbursement plan which are attributable to contributions of the employer, or are paid by the employer, are included in the employee's gross income unless such amounts are excludable under section 105(b). For amounts reimbursed to a highly compensated individual to be fully excludable from such individual's gross income under section 105(b), the plan must satisfy the requirements of section 105(h) and this section. Section 105(h) is not satisfied if the plan discriminates in favor of highly compensated individuals as to eligibility to participate or benefits. All or a portion of the reimbursements or payments on behalf of such individuals under a discriminatory plan are not excludable from gross income under section 105(b). However, benefits paid to participants who are not highly compensated individuals may be excluded from gross income if the requirements of section

105(b) are satisfied, even if the plan is discriminatory.

(b) *Self-insured medical reimbursement plan*—(1) *General rule*—(i) *Definition*. A self-insured medical reimbursement plan is a separate written plan for the benefit of employees which provides for reimbursement of employee medical expenses referred to in section 105(b). A plan or arrangement is self-insured unless reimbursement is provided under an individual or group policy of accident or health insurance issued by a licensed insurance company or under an arrangement in the nature of a prepaid health care plan that is regulated under federal or state law in a manner similar to the regulation of insurance companies. Thus, for example, a plan of a health maintenance organization, established under the Health Maintenance Organization Act of 1973, would qualify as a prepaid health care plan. In addition, this section applies to a self-insured medical reimbursement plan, determined in accordance with the rules of this section, maintained by an employee organization described in section 501(c)(9).

(ii) *Shifting of risk*. A plan underwritten by a policy of insurance or a prepaid health care plan that does not involve the shifting of risk to an unrelated third party is considered self-insured for purposes of this section. Accordingly, a cost-plus policy or a policy which in effect merely provides administrative or bookkeeping services is considered self-insured for purposes of this section. However, a plan is not considered self-insured merely because one factor the insurer uses in determining the premium is the employer's prior claims experience.

(iii) *Captive insurance company*. A plan underwritten by a policy of insurance issued by a captive insurance company is not considered self-insured for purposes of this section if for the plan year the premiums paid by companies unrelated to the captive insurance company equal or exceed 50 percent of the total premiums received and the policy of insurance is similar to policies sold to such unrelated companies.

(2) *Other rules*. The rules of this section apply to a self-insured portion of

an employer's medical plan or arrangement even if the plan is in part underwritten by insurance. For example, if an employer's medical plan reimburses employees for benefits not covered under the insured portion of an overall plan, or for deductible amounts under the insured portions, such reimbursement is subject to the rules of this section. However, a plan which reimburses employees for premiums paid under an insured plan is not subject to this section. In addition, medical expense reimbursements not described in the plan are not paid pursuant to a plan for the benefit of employees, and therefore are not excludable from gross income under section 105(b). Such reimbursements will not affect the determination of whether or not a plan is discriminatory.

(c) *Prohibited discrimination*—(1) *In general.* A self-insured medical reimbursement plan does not satisfy the requirements of section 105(h) and this paragraph for a plan year unless the plan satisfies subparagraphs (2) and (3) of this paragraph. However, a plan does not fail to satisfy the requirements of this paragraph merely because benefits under the plan are offset by benefits paid under a self-insured or insured plan of the employer or another employer, or by benefits paid under Medicare or other Federal or State law or similar foreign law. A self-insured plan may take into account the benefits provided under another plan only to the extent that the type of benefit subject to reimbursement is the same under both plans. For example, an amount reimbursed to an employee for a hospital expense under a medical plan maintained by the employer of the employee's spouse may be offset against the self-insured benefit where the self-insured plan covering the employee provides the same type of hospital benefit.

(2) *Eligibility to participate*—(i) *Percentage test.* A plan satisfies the requirements of this subparagraph if it benefits—

(A) Seventy percent or more of all employees, or

(B) Eighty percent or more of all the employees who are eligible to benefit under the plan if 70 percent or more of

all employees are eligible to benefit under the plan.

(ii) *Classification test.* A plan satisfies the requirements of this subparagraph if it benefits such employees as qualify under a classification of employees set up by the employer which is found by the Internal Revenue Service not to be discriminatory in favor of highly compensated individuals. In general, this determination will be made based upon the facts and circumstances of each case, applying the same standards as are applied under section 410(b)(1)(B) (relating to qualified pension, profit-sharing and stock bonus plans), without regard to the special rules in section 401(a)(5) concerning eligibility to participate.

(iii) *Exclusion of certain employees.* Under section 105(h)(3), for purposes of this subparagraph (2), there may be excluded from consideration:

(A) Employees who have not completed 3 years of service prior to the beginning of the plan year. For purposes of this section years of service may be determined by any method that is reasonable and consistent. A determination made in the same manner as (and not requiring service in excess of how) a year of service is determined under section 410(a)(3) shall be deemed to be reasonable. For purposes of the 3-year rule, all of an employee's years of service with the employer prior to a separation from service are not taken into account. For purposes of the 3-year rule, an employee's years of service prior to age 25, as a part-time or seasonal employee, as a member of a collective bargaining unit, or as a non-resident alien, as each is described in this subdivision, are not excluded by reason of being so described from counting towards satisfaction of the rule. In addition, if the employer is a predecessor employer (determined in a manner consistent with section 414(a)), service for such predecessor is treated as service for the employer.

(B) Employees who have not attained age 25 prior to the beginning of the plan year.

(C) Part-time employees whose customary weekly employment is less than 35 hours, if other employees in similar work with the same employer (or, if no employees of the employer

are in similar work, in similar work in the same industry and location) have substantially more hours, and seasonal employees whose customary annual employment is less than 9 months, if other employees in similar work with the same employer (or, if no employees of the employer are in similar work, in similar work in the same industry and location) have substantially more months. Notwithstanding the preceding sentence, any employee whose customary weekly employment is less than 25 hours or any employee whose customary annual employment is less than 7 months may be considered as a part-time or seasonal employee.

(D) Employees who are included in a unit of employees covered by an agreement between employee representatives and one or more employers which the Commissioner finds to be a collective bargaining agreement, if accident and health benefits were the subject of good faith bargaining between such employee representatives and such employer or employers. For purposes of determining whether such bargaining occurred, it is not material that such employees are not covered by another medical plan or that the plan was not considered in such bargaining.

(E) Employees who are nonresident aliens and who receive no earned income (within the meaning of section 911(b) and the regulations thereunder) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3) and the regulations thereunder).

(3) *Nondiscriminatory benefits*—(i) *In general*. In general, benefits subject to reimbursement under a plan must not discriminate in favor of highly compensated individuals. Plan benefits will not satisfy the requirements of this subparagraph unless all the benefits provided for participants who are highly compensated individuals are provided for all other participants. In addition, all the benefits available for the dependents of employees who are highly compensated individuals must also be available on the same basis for the dependents of all other employees who are participants. A plan that provides optional benefits to participants will be treated as providing a single benefit

with respect to the benefits covered by the option provided that (A) all eligible participants may elect any of the benefits covered by the option and (B) there are either no required employee contributions or the required employee contributions are the same amount. This test is applied to the benefits subject to reimbursement under the plan rather than the actual benefit payments or claims under the plan. The presence or absence of such discrimination will be determined by considering the type of benefit subject to reimbursement provided highly compensated individuals, as well as the amount of the benefit subject to reimbursement. A plan may establish a maximum limit for the amount of reimbursement which may be paid a participant for any single benefit, or combination of benefits. However, any maximum limit attributable to employer contributions must be uniform for all participants and for all dependents of employees who are participants and may not be modified by reason of a participant's age or years of service. In addition, if a plan covers employees who are highly compensated individuals, and the type or the amount of benefits subject to reimbursement under the plan are in proportion to employee compensation, the plan discriminates as to benefits.

(ii) *Discriminatory operation*. Not only must a plan not discriminate on its face in providing benefits in favor of highly compensated individuals, the plan also must not discriminate in favor of such employees in actual operation. The determination of whether plan benefits discriminate in operation in favor of highly compensated individuals is made on the basis of the facts and circumstances of each case. A plan is not considered discriminatory merely because highly compensated individuals participating in the plan utilize a broad range of plan benefits to a greater extent than do other employees participating in the plan. In addition, if a plan (or a particular benefit provided by a plan) is terminated, the termination would cause the plan benefits to be discriminatory if the duration of the plan (or benefit) has the effect of discriminating in favor of highly compensated individuals. Accordingly, the

prohibited discrimination may occur where the duration of a particular benefit coincides with the period during which a highly compensated individual utilizes the benefit.

(iii) *Retired employees.* To the extent that an employer provides benefits under a self-insured medical reimbursement plan to a retired employee that would otherwise be excludible from gross income under section 105(b), determined without regard to section 105(h), such benefits shall not be considered a discriminatory benefit under this paragraph (c). The preceding sentence shall not apply to a retired employee who was a highly compensated individual unless the type, and the dollar limitations, of benefits provided retired employees who were highly compensated individuals are the same for all other retired participants. If this subdivision applies to a retired participant, that individual is not considered an employee for purposes of determining the highest paid 25 percent of all employees under paragraph (d) of this section solely by reason of receiving such plan benefits.

(4) *Multiple plans, etc.—(i) General rule.* An employer may designate two or more plans as constituting a single plan that is intended to satisfy the requirements of section 105(h)(2) and paragraph (c) of this section, in which case all plans so designated shall be considered as a single plan in determining whether the requirements of such section are satisfied by each of the separate plans. A determination that the combination of plans so designated does not satisfy such requirements does not preclude a determination that one or more of such plans, considered separately, satisfies such requirements. A single plan document may be utilized by an employer for two or more separate plans provided that the employer designates the plans that are to be considered separately and the applicable provisions of each separate plan.

(ii) *Other rules.* If the designated combined plan discriminates as to eligibility to participate or benefits, the amount of excess reimbursement will be determined under the rules of section 105(h)(7) and paragraph (e) of this section by taking into account all re-

imbursements made under the combined plan.

(iii) *H.M.O. participants.* For purposes of section 105(h)(2)(A) and paragraph (c)(2) of this section, a self-insured plan will be deemed to benefit an employee who has enrolled in a health maintenance organization (HMO) that is offered on an optional basis by the employer in lieu of coverage under the self-insured plan if, with respect to that employee, the employer's contributions to the HMO plan equal or exceed those that would be made to the self-insured plan, and if the HMO plan is designated in accordance with subdivision (i) with the self-insured plan as a single plan. For purposes of section 105(h) and this section, except as provided in the preceding sentence, employees covered by, and benefits under, the HMO plan are not treated as part of the self-insured plan.

(d) *Highly compensated individuals defined.* For purposes of section 105(h) and this section, the term "highly compensated individual" means an individual who is—

- (1) One of the 5 highest paid officers,
- (2) A shareholder who owns (with the application of section 318) more than 10 percent in value of the stock of the employer, or
- (3) Among the highest paid 25 percent of all employees (including the 5 highest paid officers, but not including employees excludable under paragraph (c)(2)(iii) of this section who are not participants in any self-insured medical reimbursement plan of the employer, whether or not designated as a single plan under paragraph (c)(4) of this section, or in a health maintenance organization plan).

The status of an employee as an officer or stockholder is determined with respect to a particular benefit on the basis of the employee's officer status or stock ownership at the time during the plan year at which the benefit is provided. In calculating the highest paid 25 percent of all employees, the number of employees included will be rounded to the next highest number. For example, if there are 5 employees, the top two are in the highest paid 25 percent. The level of an employee's compensation is determined on the basis of the employee's compensation for the plan

year. For purposes of the preceding sentence, fiscal year plans may determine employee compensation on the basis of the calendar year ending within the plan year.

(e) *Excess reimbursement of highly compensated individual*—(1) *In general.* For purposes of section 105(h) and this section, a reimbursement paid to a highly compensated individual is an excess reimbursement if it is paid pursuant to a plan that fails to satisfy the requirements of paragraph (c)(2) or (c)(3) for the plan year. The amount reimbursed to a highly compensated individual which constitutes an excess reimbursement is not excludable from such individual's gross income under section 105(b).

(2) *Discriminatory benefit.* In the case of a benefit available to highly compensated individuals but not to all other participants (or which otherwise discriminates in favor of highly compensated individuals as opposed to other participants), the amount of excess reimbursement equals the total amount reimbursed to the highly compensated individual with respect to the benefit.

(3) *Discriminatory coverage.* In the case of benefits (other than discriminatory benefits described in subparagraph (2)) paid to a highly compensated individual under a plan which fails to satisfy the requirements of paragraph (c)(2) relating to nondiscrimination in eligibility to participate, the amount of excess reimbursement is determined by multiplying the total amount reimbursed to the individual by a fraction. The numerator of the fraction is the total amount reimbursed during that plan year to all highly compensated individuals. The denominator of the fraction is the total amount reimbursed during that plan year to all participants. In computing the fraction and the total amount reimbursed to the individual, discriminatory benefits described in subparagraph (2) are not taken into account. Accordingly, any amount which is included in income by reason of the benefit's not being available to all other participants will not be taken into account.

(4) *Examples.* The provisions of this paragraph are illustrated by the following examples:

Example 1. Corporation M maintains a self-insured medical reimbursement plan which covers all employees. The plan provides the following maximum limits on the amount of benefits subject to reimbursement: \$5,000 for officers and \$1,000 for all other participants. During a plan year Employee A, one of the 5 highest paid officers, received reimbursements in the amount of \$4,000. Because the amount of benefits provided for highly compensated individuals is not provided for all other participants, the plan benefits are discriminatory. Accordingly, Employee A received an excess reimbursement of \$3,000 (\$4,000-\$1,000) which constitutes a benefit available to highly compensated individuals, but not to all other participants.

Example 2. Corporation N maintains a self-insured medical reimbursement plan which covers all employees. The plan provides a broad range of medical benefits subject to reimbursement for all participants. However, only the 5 highest paid officers are entitled to dental benefits. During the plan year Employee B, one of the 5 highest paid officers, received dental payments under the plan in the amount of \$300. Because dental benefits are provided for highly compensated individuals, and not for all other participants, the plan discriminates as to benefits. Accordingly, Employee B received an excess reimbursement in the amount of \$300.

Example 3. Corporation O maintains a self-insured medical reimbursement plan which discriminates as to eligibility by covering only the highest paid 40% of all employees. Benefits subject to reimbursement under the plan are the same for all participants. During a plan year Employee C, a highly compensated individual, received benefits in the amount of \$1,000. The amount of excess reimbursement paid Employee C during the plan year will be calculated by multiplying the \$1,000 by a fraction determined under subparagraph (3).

Example 4. Corporation P maintains a self-insured medical reimbursement plan for its employees. Benefits subject to reimbursement under the plan are the same for all plan participants. However, the plan fails the eligibility tests of section 105(h)(3)(A) and thereby discriminates as to eligibility. During the 1980 plan year Employee D, a highly compensated individual, was hospitalized for surgery and incurred medical expenses of \$4,500 which were reimbursed to D under the plan. During that plan year the Corporation P medical plan paid \$50,000 in benefits under the plan, \$30,000 of which constituted benefits paid to highly compensated individuals. The amount of excess reimbursement not excludable by D under section 105(b) is \$2,700:

$$\$4500 \times \frac{\$30,000}{\$50,000}$$

Example 5. Corporation Q maintains a self-insured medical reimbursement plan for its employees. The plan provides a broad range of medical benefits subject to reimbursement for participants. However, only the five highest paid officers are entitled to dental benefits. In addition, the plan fails the eligibility test of section 105(h)(3)(A) and thereby discriminates as to eligibility. During the calendar 1981 plan year, Employee E, a highly compensated individual, received dental benefits under the plan in the amount of \$300, and no other employee received dental benefits. In addition, Employee E was hospitalized for surgery and incurred medical expenses, reimbursement for which was available to all participants, of \$4,500 which were reimbursed to E under the plan. Because dental benefits are only provided for highly compensated individuals, Employee E received an excess reimbursement under paragraph (e)(2) above in the amount of \$300. For the 1981 plan year, the Corporation Q medical plan paid \$50,300 in total benefits under the plan, \$30,300 of which constituted benefits paid to highly compensated individuals. In computing the fraction under paragraph (e)(3), discriminatory benefits described in paragraph (e)(2) are not taken into account. Therefore, the amount of excess reimbursement not excludable to Employee E with respect to the \$4,500 of medical expenses incurred is \$2,700:

$$\$4500 \times \frac{\$30,000}{\$50,000}$$

and the total amount of excess reimbursements includable in E's income for 1981 is \$3,000.

Example 6. (i) Corporation R maintains a calendar year self-insured medical reimbursement plan which covers all employees. The type of benefits subject to reimbursement under the plan include all medical care expenses as defined in section 213(e). The amount of reimbursement available to any employee for any calendar year is limited to 5 percent of the compensation paid to each employee during the calendar year. The amount of compensation and reimbursement paid to Employees A-F for the calendar year is as follows:

Employee	Compensation	Reimbursable amount paid
A	\$100,000	\$5,000
B	25,000	1,250
C	15,000	750
D	10,000	500
E	10,000	500
F	8,000	400
		8,400

(ii) Because the amount of benefits subject to reimbursement under the plan is in pro-

portion to employee compensation the plan discriminates as to benefits. In addition, Employees A and B are highly compensated individuals. The amount of excess reimbursement paid Employees A and B during the plan year will be determined under paragraph (e)(2). Because benefits in excess of \$400 (Employee F's maximum benefit) are provided for highly compensated individuals and not for all other participants, Employees A and B received, respectively, an excess reimbursement of \$4,600 and \$850.

(f) *Certain controlled groups.* For purposes of applying the provisions of section 105(h) and this section, all employees who are treated as employed by a single employer under section 414 (b) and (c), and the regulations thereunder (relating to special rules for qualified pension, profit-sharing and stock bonus plans), shall be treated as employed by a single employer.

(g) *Exception for medical diagnostic procedures—(1) In general.* For purposes of applying section 105(h) and this section, reimbursements paid under a plan for medical diagnostic procedures for an employee, but not a dependent, are not considered to be a part of a plan described in this section. The medical diagnostic procedures include routine medical examinations, blood tests, and X-rays. Such procedures do not include expenses incurred for the treatment, cure or testing of a known illness or disability, or treatment or testing for a physical injury, complaint or specific symptom of a bodily malfunction. For example, a routine dental examination with X-rays is a medical diagnostic procedure, but X-rays and treatment for a specific complaint are not. In addition, such procedures do not include any activity undertaken for exercise, fitness, nutrition, recreation, or the general improvement of health unless they are for medical care as defined in section 213(e). The diagnostic procedures must be performed at a facility which provides no services (directly or indirectly) other than medical, and ancillary, services. For purposes of the preceding sentence, physical proximity between a medical facility and non-medical facilities will not for that reason alone cause the medical facility not to qualify. For example, an employee's annual physical examination conducted at the employee's personal physician's office is not considered a

part of the medical reimbursement plan and therefore is not subject to the nondiscrimination requirements. Accordingly, the amount reimbursed may be excludable from the employee's income if the requirements of section 105(b) are satisfied.

(2) *Transportation, etc. expenses.* Transportation expenses primarily for an allowable diagnostic procedure are included within the exception described in this paragraph, but only to the extent they are ordinary and necessary. Transportation undertaken merely for the general improvement of health, or in connection with a vacation, is not within the scope of this exception, nor are any incidental expenses for food or lodging; therefore, amounts reimbursed for such expenses may be excess reimbursements under paragraph (e).

(h) *Time of inclusion.* Excess reimbursements (determined under paragraph (e)) paid to a highly compensated individual for a plan year will be considered as received in the taxable year of the individual in which (or with which) the plan year ends. The particular plan year to which reimbursements relate shall be determined under the plan provisions. In the absence of plan provisions reimbursements shall be attributed to the plan year in which payment is made. For example, under a calendar year plan an excess reimbursement paid to A in 1981 on account of an expense incurred and subject to reimbursement for the 1980 plan year under the terms of the plan will be considered as received in 1980 by A.

(i) *Self-insured contributory plan.* A medical plan subject to this section may provide for employer and employee contributions. See § 1.105-1(c). The tax treatment of reimbursements attributable to employee contributions is determined under section 104(a)(3). The tax treatment of reimbursements attributable to employer contributions is determined under section 105. The amount of reimbursements which are attributable to contributions of the employer shall be determined in accordance with § 1.105-1(e).

(j) *Effective date.* Section 105(h) and this section are effective for taxable years beginning after December 31, 1979 and for amounts reimbursed after De-

cember 31, 1979. In determining plan discrimination and the taxability of excess reimbursements made for a plan year beginning in 1979 and ending in 1980, a plan's eligibility and benefit requirements as well as actual reimbursements made in the plan year during 1979, will not be taken into account. In addition, this section does not apply to expenses which are incurred in 1979 and paid in 1980.

(k) *Special rules—(1) Relation to cafeteria plans.* If a self-insured medical reimbursement plan is included in a cafeteria plan as described in section 125, the rules of this section will determine the status of a benefit as a taxable or nontaxable benefit, and the rules of section 125 will determine whether an employee is taxed as though he elected all available taxable benefits (including taxable benefits under a discriminatory medical reimbursement plan). This rule is illustrated by the following example:

Example. Corporation M maintains a cafeteria plan described in section 125. Under the plan an officer of the corporation may elect to receive medical benefits provided by a self-insured medical reimbursement plan which is subject to the rules of this section. However, the self-insured medical reimbursement plan fails the nondiscrimination rules under paragraph (c) of this section. Accordingly, the amount of excess reimbursement is taxable to the officer participating in the medical reimbursement plan pursuant to section 105(h) and this section. Therefore, the self-insured medical reimbursement plan will be considered a taxable benefit under section 125 and the regulations thereunder.

(2) *Benefit subject to reimbursement.* For purposes of this section, a benefit subject to reimbursement is a benefit described in the plan under which a claim for reimbursement or for a payment directly to the health service provider may be filed by a plan participant. It does not refer to actual claims or benefit reimbursements paid under a plan.

[T.D. 7754, 46 FR 3505, Jan. 15, 1981]

§ 1.106-1 Contributions by employer to accident and health plans.

The gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through