

## Chapter 5

# Enrollment, Election, and Other Eligibility Records

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| <p><b>A. Overview: What Are Eligibility Records?</b></p> <p><b>B. Records Relating to Employee Eligibility</b></p> <p><b>C. Records Relating to Spouse Eligibility</b></p> <p><b>D. Records Relating to Dependent Child Eligibility</b></p> <p><b>E. Records Relating to Domestic Partner Eligibility</b></p> | <p><b>F. Enrollments, Salary Reduction Elections, and Election Changes</b></p> <p><b>G. Insurance Applications From Eligible Individuals</b></p> <p><b>H. Beneficiary Designations and Related Records</b></p> <p><b>I. Communications With Insurers Regarding Eligibility</b></p> <p><b>J. Lists of Eligible Individuals</b></p> |
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**Caution.** Summaries in this book of various ERISA, Code, and other rules are intended only to orient the reader to the record categories being discussed. The summaries are *not* intended as a compliance guide and contain only brief highlights of the rules, the complexity and detail of which are beyond the scope of this book.

### A. Overview: What Are Eligibility Records?

ERISA does not dictate eligibility provisions for ERISA health and welfare plans like it does for pension plans. As a result, plan sponsors have wide freedom to determine which individuals will be eligible for plan benefits (subject, of course, to other laws prohibiting discrimination, group health plan mandates like COBRA and HIPAA's portability rules, and tax considerations). With respect to tax considerations, the Code does impose eligibility requirements as a condition of the tax status of certain ERISA and non-ERISA fringe benefits.<sup>1</sup>

Identifying who is eligible to receive plan benefits is an essential aspect of plan administration. In addition, eligible individuals must be identified for other plan administration reasons (e.g., for purposes of providing enrollment information). This Chapter addresses the records that may be required, depending on the particular eligibility provisions of the ERISA plan in question.

### B. Records Relating to Employee Eligibility

Eligibility rules and requirements for ERISA welfare plans must be addressed in the plan document (among many other issues) in order to satisfy the general requirements of ERISA § 402<sup>2</sup> and must also appear in the plan's SPD.<sup>3</sup> There are, of course, as many possible employee eligibility definitions as there are plans and workplaces, making it

<sup>1</sup> For example, under Code §§ 105 and 106, the value of employer-provided health coverage for employees, their spouses and tax dependents is exempt from federal income tax and employment taxes, and reimbursements for medical expenses are typically tax-free as well).

<sup>2</sup> ERISA § 402 (plans must "be established and maintained pursuant to a written instrument" that describes the rights and obligations of persons covered by the plan and specifies the basis on which payments are made to and from the plan).

<sup>3</sup> ERISA § 102(b); and DOL Reg. §§ 2520.102-3(j) and (l).

impossible to generalize about what records will be required for particular plans. The following addresses some commonly encountered employee eligibility requirements and the corresponding records that might substantiate eligibility.<sup>4</sup> In addition, the Code imposes eligibility rules for employee fringe benefits that may be provided on a tax-free or tax-favored basis. Records necessary to demonstrate compliance with these eligibility rules are also addressed below.

### ***1. Records Identifying Which Individuals Are Employees***

**🕒 Recommended Record Retention Period.** Employee eligibility records for ERISA plans should be retained for as long as the employee is eligible under the plan in question, plus eight years (under ERISA § 107—for plans required to report claims information on Form 5500) or the statute of limitations period for benefit claims under the plan, whichever is longer. Employee eligibility records for cafeteria plans, DCAPs, HSAs (not subject to ERISA), and qualified educational assistance programs should be retained for as long as the employee is eligible under the plan in question, plus five years (under Code § 6039D) or the statute of limitations period for benefit claims under the plan, whichever is longer. *Chapter 2 discusses the referenced retention period(s) in more detail.*

Typical eligibility definitions require that an individual be an employee of the sponsoring employer in order to be eligible for benefits (other conditions, addressed below, may also be imposed). If the plan document does not clearly define the term “employee,” the courts in the event of a dispute will look elsewhere. For instance, ERISA defines “employee” simply as “any individual employed by an employer.”<sup>5</sup> The U.S. Supreme Court has held that when there is ambiguity about whether an individual seeking benefits is an employee, the common-law definition of employee applies.<sup>6</sup> Under that test, the key issue is the hiring party’s right to control the manner and means by which work is done by the individual in question.<sup>7</sup> Ordinarily, the employee status of an individual will be established by records like employment agreements, hiring letters,

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<sup>4</sup> ERISA plans are not, in general, required to limit eligibility to common-law employees. Plans may be designed to cover other individuals, (e.g., independent contractors or partners), although such a plan design might make the plan a multiple employer welfare plan (MEWA) subject to greater state insurance law regulation than would otherwise apply to an ERISA plan. *See American Bar Association Joint Committee on Employee Benefits Questions and Answers with the DOL (May 18, 2005), Q/A-14, available at <http://www.abanet.org/jceb/2005/qa05dol.pdf>.*

<sup>5</sup> ERISA § 3(6).

<sup>6</sup> *Nationwide Mutual Insurance Co. v. Darden*, 503 U.S. 318, 14 EBC 2625 (1992); *see also Capital Cities/ABC, Inc. v. Rاتcliff*, 141 F.3d 1405, 22 EBC 1004 (10th Cir. 1998) (well established that when a statute does not meaningfully define employee, then traditional notions of agency law are incorporated).

<sup>7</sup> *Nationwide Mutual Insurance Co. v. Darden*, 503 U.S. 318, 14 EBC 2625 (1992), identified the following factors as relevant in determining employee status: the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party’s discretion over when and how long to work; the method of payment; the hired party’s role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party. *See also IRS Pub. 15-A (Employer’s Supplemental Tax Guide)*, “1. Who are Employees?” and “2. Employee or Independent Contractor?” available at <http://www.irs.gov/publications/p15a/index.html>.

or similar documents.<sup>8</sup> Where there is no employment agreement or similar document, records showing treatment as an employee may be sufficient (e.g., payroll records listing the individual or tax records showing payment of employment taxes with respect to the individual). In other situations, however, these basic records may be inconclusive or inconsistent with other relevant factors and thus raise questions about an individual's status as an employee (e.g., where the individual is hired through a leasing agency or professional employee organization).<sup>9</sup> Discussion of the more complicated records (including possible testimony of individuals familiar with the employer's practices) required in such cases is beyond the scope of this book.<sup>10</sup>

## 2. *Records Supporting Service and Other Plan Requirements for Employee Eligibility*

**🕒 Recommended Record Retention Period.** Employee eligibility records should be retained for as long as the employee is eligible under the plan in question, plus eight years (under ERISA § 107—for plans required to report claims information on Form 5500) or the statute of limitations period for benefit claims under the plan, whichever is longer. *Chapter 2 discusses the referenced retention period(s) in more detail.*

### a. **Records Supporting Service Requirements for Employee Eligibility**

Employee eligibility is often also tied to satisfaction of minimum service or work requirements, substantiation of which may require records like employee work schedules (where eligibility is based on hours of scheduled work) or logs or other records showing actual hours worked by employees (e.g., employee sign-in sheets, timesheets or employee-submitted reports of hours worked or of time off, or cards or other records reflecting clocked hours).

### b. **Records Identifying Eligible Classes of Employees**

Some eligibility provisions limit employee eligibility to individuals working in certain employee classifications, such as full-time employees, regular employees, or part-time employees.<sup>11</sup> Such designations may be reflected in various records, including employment contracts, hire letters, or simple file memos categorizing employees by classification.<sup>12</sup>

<sup>8</sup> What written contracts say about the parties' relationship is one of the factors recognized by the IRS as relevant for tax purposes (although it is not necessarily determinative). IRS Pub. 15-A (Employer's Supplemental Tax Guide), "1. Who are Employees?" and "2. Employee or Independent Contractor?," available at <http://www.irs.gov/publications/p15a/index.html>.

<sup>9</sup> See, e.g., DOL Advisory Opinion 92-05A, 1992 ERISA LEXIS 1 (Jan. 27, 1992).

<sup>10</sup> It should be noted that the courts will not always insist on written records to demonstrate who is an employee. See, e.g., *Belluardo v. Cox Enters.*, 157 Fed. Appx. 823, 36 EBC 1742 (6th Cir. 2005) (rejecting argument that personnel policy, on which plan's eligibility provision was based, must be in writing).

<sup>11</sup> ERISA plans, of course, may also provide benefits to retired employees (e.g., under retiree health plans) and to otherwise separated employees (e.g., under severance plans). Records documenting the status of eligible former employees would need to be retained under these plans for as long as individuals remain eligible under the plan plus the eight-year rule of thumb under ERISA § 107 (for plans required to report claims information on Form 5500) or the statute of limitations period for benefit claims under the plan, whichever is longer. Chapter 2 discusses the referenced retention period(s) in more detail.

<sup>12</sup> Of course, sometimes these terms are stand-ins for service requirements. See, e.g., *Burnham v. The Guardian Life Ins. Co.*, 873 F.2d 486 (1st Cir. 1989) (term "full-time" defined to mean working certain minimum hours per week). Failure to further define general terms like these invites disputes and should be avoided.

### **c. Records Relating to Other Employee Eligibility Conditions**

Some other typical employee eligibility conditions include compensation requirements (e.g., eligibility for supplemental life insurance coverage is often tied to compensation levels, which would be substantiated by payroll records) or age requirements (e.g., group health plans that cover retirees often limit eligibility to retirees who are over 65, in order to coordinate with Medicare benefits).<sup>13</sup> In addition, there are location-of-work restrictions (e.g., requiring that eligible employees perform work at the employer's business location) and actively-at-work requirements. Records to substantiate these types of requirements may not be the sort that are generated in the normal course, so that employers administering such eligibility requirements may be advised to create special records for this purpose. This might include requiring regular, written reports regarding where work is performed by employees who are permitted to work at home, who travel for long periods away from the workplace, or who regularly perform work off-site for customers of the employer.

### **d. Records Relating to Termination of Eligibility for Cause**

Welfare plans may terminate employee eligibility and coverage for cause. For example, plan coverage may be terminated for submission of fraudulent claims or for covering ineligible dependents (e.g., divorced spouses or over-age dependent children).<sup>14</sup> If eligibility can be terminated for cause, the plan document and SPD should expressly say so. In addition, records should be retained (for as long as the employee in question would otherwise be eligible under the plan) that document the reasons why eligibility was terminated.

## **3. Records Relating to Code Eligibility Rules for Cafeteria Plans, Health FSAs, DCAPs, and Other Fringe Benefits**

The Code imposes eligibility rules for employee fringe benefits that may be provided on a tax-free or tax-favored basis. Records should be retained to show that only eligible individuals are permitted to participate, as addressed below.

### **a. Eligibility Rules for Cafeteria Plans, Health FSAs, and DCAPs**

**🕒 Recommended Record Retention Period.** Records reflecting compliance with the Code's eligibility rules, addressed below, generally should be retained for at least five years (under Code § 6039D). *Chapter 2 discusses the referenced retention period(s) in more detail.*

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<sup>13</sup> The propriety of Medicare coordination for retirees is not entirely clear. The EEOC issued proposed regulations in 2003 that generally sanction the practice; however, final publication of the regulations has been enjoined as a result of legal challenges (based on the Third Circuit's decision in *Erie County Retirees Ass'n v. County of Erie*, 220 F.3d 193, 24 EBC 2390 (3d Cir. 2000), which held that Medicare coordination violated the Age Discrimination in Employment Act). See *AARP v. EEOC*, No. 05-CV-509 (E.D. Pa. Sept. 27, 2005).

<sup>14</sup> See Treas. Reg. § 54.4980B-7, Q/A-1(b) (COBRA regulations permitting termination of COBRA coverage under a group health plan on the same basis as coverage may be terminated for active employees—e.g., for cause). See also *Trustees of AFTRA Health Fund v. Biondi*, 303 F.3d 765, 28 EBC 2409 (7th Cir. 2002) (employee who kept spouse enrolled in health plan for five years after divorce committed fraud and was required to reimburse plan); *Trustees of the Nat'l Automatic Sprinkler Industry Welfare Fund v. Olsen*, 914 F. Supp. 1250 (D. Md. 1996) (employee who misrepresented that he was married to his girlfriend in order to obtain coverage for her discovered when plan adds documentation requirements).

Only employees of the sponsoring employer (or employees in its controlled group) can participate in a cafeteria plan.<sup>15</sup> Some individuals are not eligible to participate in a cafeteria plan (including, for example, self-employed individuals such as sole proprietors, partners in a partnership, and more-than-2%-shareholders in a Subchapter S corporation). Consequently, self-employed individuals cannot participate in a health FSA or DCAP that is offered through a cafeteria plan.<sup>16</sup> Section B addresses records to substantiate employee status.

**b. HSA Eligible Individual Must Have HDHP Coverage and No Disqualifying Coverage**

**🕒 Recommended Record Retention Period.** Records reflecting compliance with the Code's eligibility rules, addressed below, generally should be retained for at least five years (under Code § 6039D). *Chapter 2 discusses the referenced retention period(s) in more detail.*

For HSA eligibility, an individual need not be an employee<sup>17</sup> but must be covered under an HDHP for the months for which contributions are made to the HSA.<sup>18</sup> In addition, the individual must not have any non-HDHP coverage unless it falls into one or more of the following three categories: preventive care,<sup>19</sup> permitted coverage,<sup>20</sup> or permitted insurance.<sup>21</sup> Many employers require employees electing contributions to an HSA to certify that they meet the requirements of Code § 223. IRS guidance provides that an employer is responsible for determining only the following with respect to an employee's eligibility for HSA contributions: (1) whether the employee is covered under an HDHP sponsored by the employer and the deductible (presumably for setting a limit on the contributions made to the employee's HSA); (2) whether the employee is covered under a non-HDHP (including health FSAs and HRAs) sponsored by the employer; and (3) the employee's age (for catch-up contributions).<sup>22</sup> Copies of such certifications should be retained for the record retention period noted above.

<sup>15</sup> Code § 125(d)(1) and Prop. Treas. Reg. § 1.125-1, Q/A-4.

<sup>16</sup> *See also* Code § 105(g) (self-employed individuals not considered employees for purposes of Code § 105 provisions regarding accident and health plans). Note that self-employed individuals can participate in a DCAP that is funded outside a cafeteria plan (e.g., an arrangement that is financed entirely by the employer). Code § 129(e)(3). As a practical matter, however, the DCAP nondiscrimination rules may be a roadblock to such arrangements.

<sup>17</sup> Only employees, however, can make HSA contributions through a cafeteria plan due to the cafeteria plan eligibility rules.

<sup>18</sup> Code § 223(c)(1)(A)(i). *See also* IRS Notice 2004-2, 2004-2 I.R.B. 269, Q/A-1.

<sup>19</sup> Code § 223(c)(2)(C).

<sup>20</sup> Code § 223(c)(1)(B)(ii).

<sup>21</sup> Code §§ 223(c)(1)(B)(i) and 223(c)(3).

<sup>22</sup> IRS Notice 2004-50, 2004-33 I.R.B. 196, Q/A-81. In determining an employee's age, the employer may rely on the employee's representation as to his or her date of birth. In addition, employer HSA contributions are not subject to withholding from wages for income tax or subject to FICA, FUTA, or RRTA taxes if at the time of the contribution, it is reasonable to believe that the employee will be able to exclude the payment from the employee's income under Code § 106(d). Code §§ 3306(b)(18) (FUTA), 3401(a)(22) (income tax withholding), and 3231(e)(11) (Railroad Retirement Tax Act); IRS Notice 2004-2, 2004-2 I.R.B. 269, Q/A-19; and Instructions for Forms W-2 and W-3 (FICA taxes).