To: Participating Employers, IAFF Medical Expense Reimbursement Plan

From: Trust Legal Counsel

Re: **Analysis of Internal Revenue Code Section 105(h) HCI issue in context of higher contributions for management employees**

Date: July 9, 2026

The Wagner Law Group serves as Legal Counsel to the IAFF Medical Expense Reimbursement Plan (IAFF MERP). The Board of Trustees of IAFF MERP asked Legal Counsel to research restrictions on contributions[1] to IAFF MERP for management employees, and whether management employees are highly compensated individuals (HCI) under Internal Revenue Code Section 105(h).

After reviewing available regulatory guidance on this matter, we were able to advise that the IRS would likely conclude that retirees receiving reimbursements from the current IAFF MERP plan design would not qualify as HCIs under Code Section 105(h),[2] and based upon this advice, the Board of Trustees decided that it will no longer cap the contribution levels of bargaining units of management employees.

- *Time Period for Evaluation of HCI Status under IRS Regulations.* The IRS regulations indicate that determination of whether a beneficiary is an HCI (under Code Section 105(h)) is made "on the basis of the employee's compensation for the plan year."[3] Because the current IAFF MERP terms require a retiree to cease all employment with the participating employer in order to become eligible to receive benefit payments, most IAFF MERP eligible retirees would have $0 compensation from the employer during the Plan year in which benefits are received.[4] Therefore, these IAFF MERP eligible retirees cannot qualify as HCIs with $0 compensation. This reasoning also correlates

[1] Code Section 105(h)(2)(B) (providing that plan "benefits," not contributions, cannot discriminate in favor of HCIs). However, due to IAFF MERP Plan design, higher contributions generally lead to higher benefits.
[2] Currently, the approach for avoiding discriminatory benefits in IAFF MERP has been to cap management employee contributions at the level of rank and file bargaining unit contributions. This more conservative approach is based upon the public policies underlying the adoption of IRC Section 105(h) and IRS positions related to other retirement benefits.
[3] *See* Treas. Reg. 1.105-11(d) (interpreting Code Section 105(h)(5)).
[4] In the first year of receiving benefits from the IAFF MERP, eligible retirees will likely have some compensation from the employer up to the date of their retirement and initial receipt of benefits from the IAFF MERP. Employees who retire later in the Plan year will have a longer period of compensation during their initial year of receiving benefits, and therefore, could theoretically be an HCI, but the monthly benefits from the IAFF MERP will be correspondingly lower during that Plan year due to the number of months left in the plan year for benefit payments. Thus, these retirees are unlikely to receive an excess benefit in that plan year. Conversely, employees who retire earlier in the Plan year will receive a lower amount of compensation from the employer and it will be unlikely for them to be determined an HCI for the plan year.

with the implied IRS position in the PLR (described in the next bullet point) that retired participants cannot be among the highest paid top 25 percent.

- *IRS Evaluation of Retired Participants for HCI Status.* The one IRS private letter ruling in this area supports the position that a retired participant can only be an HCI through being one of the 5 highest paid officers or a 10% shareholder,[5] neither of which would generally apply to an IAFF MERP retiree of a public employer. While a public employer has executive positions, such as mayor, council member, city or county manager, these positions are not generally considered officers in the context presumed for these regulations. Even if a retiree participant was in an executive management position that could be analogized to the position of an officer in a private employer context, the retiree would not be eligible to receive benefits from IAFF MERP while working in that position. Using the plan year of benefits analysis for determining who is an HCI essentially eliminates the possibility of discrimination in favor of HCIs under the current IAFF MERP plan design. Moreover, public employers do not issue stock or have shareholders.

- *Evaluating Each Bargaining Unit as a Separate Plan: Exception from Eligibility Discrimination Testing.* Each employer is evaluated separately for discrimination testing under Code Section 105(h), and the employer can designate plans as separate or constituting a single plan.[6] If an employer participates in the IAFF MERP with different contribution rates by bargaining unit (thus resulting in different benefit levels by bargaining unit), the employer can evaluate each bargaining unit as a separate plan for discrimination testing and avoid discrimination in benefits within each plan. Evaluating the plans separately would mean that there would be no discriminatory benefits in favor of HCIs in either of the plans because the contributions, and thus benefit levels, would be the same for all participants within each plan, provided the contributions are the same for all members of a bargaining unit. Provided the contributions for both the rank and file bargaining unit and the management bargaining unit were collectively bargained, it also appears that the employer could take advantage of the pension plan exception for collectively bargained plans in Code Section 410(b)(3)(A). For eligibility testing, the 105(h) regulations refer to and allow use of

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[5] *See* I.R.S. Priv. Ltr. Rul. 8328065 (April 13, 1983) (stating that, "in general … a self-insured medical reimbursement plan will be considered to discriminate in benefits if the benefits available to retirees who were one of the five highest paid officers or a shareholder who owns more than 10 percent of the value of the stock of the employer are not the same for all retirees."); Treas. Reg. §1.105-11(c)(3)(iii).

[6] *See* Treas. Reg. Sect. 1.105-11(c)(4), which states "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 provision of each plan." In IRS Memorandum FREV-113006-01, Technical Assistance Request, May 1, 2002, the IRS applied this section of the regulations to test two separate plans (one for surviving spouses and dependents of physician employees and one for all other participants) in order to pass the discriminatory benefits test. In IRS Memorandum FREV-104062-98, Technical Assistance Request, April 28, 1998, the IRS applied the same testing strategy to group participants into 9 separate plans, each having identical benefits, in order to pass the discriminatory benefits test.

the classification test under Code Section 410(b)(1)(B),[7] which is subject to the collectively bargained plan exception.

TO ENSURE COMPLIANCE WITH REQUIREMENTS IMPOSED BY THE IRS, WE INFORM YOU THAT ANY U.S. FEDERAL TAX ADVICE CONTAINED IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, FOR THE PURPOSE OF (I) AVOIDING PENALTIES UNDER THE INTERNAL REVENUE CODE OR (II) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY TRANSACTION OR MATTER ADDRESSED HEREIN.

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[7] *See* Treas. Reg. Sect. 1.105-11(c)(2)(ii).