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EMPLOYEE BENEFITS COMPLIANCE BRIEF



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Stay Compliant with the Employee Benefits Compliance Brief

An exclusive UBA Partner Firm monthly newsletter, focusing on one of your most important responsibilities — employer compliance.

September 2026

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Proposed Regulations Address Employer Contributions to Trump Accounts and Dependent Care Nondiscrimination Testing

The Department of the Treasury and the IRS have issued [proposed regulations](#) providing guidance on employer contributions to Trump Accounts and clarifying nondiscrimination testing for dependent care assistance plans (DCAPs).

The proposed regulations address Internal Revenue Code Section 128, which governs tax-favored employer contributions to Trump Accounts, and Section 129, which governs dependent care assistance programs.

Organizations considering Trump Account contributions now have a proposed framework for designing and administering the benefit. Employers already offering dependent care flexible spending accounts or other DCAP benefits also have more detail about how Treasury and the IRS propose to apply longstanding nondiscrimination requirements.

Employer Contributions to Trump Accounts

An employer may contribute up to \$2,500 per employee per year to a Trump Account, with the limit subject to inflation adjustments after 2027. Qualifying employer contributions are excluded from the employee's gross income.

The \$2,500 limit applies per employee, not per Trump Account or dependent. An employee with multiple eligible dependents does not receive a separate \$2,500 employer contribution limit for each dependent. The limit also applies across employers if an employee works for more than one employer.

To receive the favorable tax treatment, contributions must be made through a qualifying Trump Account contribution program. The program must have a separate written plan, and comply with applicable requirements, including nondiscrimination rules.

The proposal would also allow a Trump Account contribution program to operate through a Section 125 cafeteria plan in certain circumstances.

Employees could make pre-tax salary reduction contributions to a dependent's Trump Account through a cafeteria plan but not to fund their own Trump Accounts.

Employers interested in adding this feature would therefore need to consider both their Trump Account program document and their Section 125 cafeteria plan document.

As with other tax-favored accounts, Trump Account contribution programs may not disproportionately favor highly compensated employees (HCEs) or their dependents. The proposed regulations provide detailed rules for evaluating both eligibility and benefits under an employer's program.

Eligible Investments for Trump Accounts

During a Trump Account's growth period, investment of account assets may only be made in funds that meet specific eligibility requirements. The growth period starts when the beneficiary's first Trump Account is established and continues through December 31 of the calendar year in which the beneficiary turns age 17. Once this period ends, the restrictions limiting the account to eligible investments no longer apply.

Generally, an eligible investment for a Trump Account is a mutual fund or exchange-traded fund (ETF) that:

- Tracks an equity index composed primarily of U.S. companies, such as the S&P 500 Index,
- Does not use leverage, and
- Charges annual fees and expenses of no more than 0.1% of the amount invested in the fund.

If the beneficiary does not choose an eligible investment from the options made available by the account trustee, the trustee will automatically invest the account funds in an eligible investment for the growth period.

Proposed DCAP Rules Provide Long-Awaited Testing Detail

The same proposed regulations provide detailed rules for applying Section 129 **nondiscrimination** requirements to dependent care assistance plans (DCAPs).

Section 129 requires DCAPs to satisfy several nondiscrimination requirements. These include tests concerning contributions and benefits, eligibility, benefits provided to certain owners, and average benefits. When a

program fails applicable nondiscrimination requirements, the tax consequences generally fall on HCEs rather than non-highly compensated employees (NHCEs).

Who Would Be an HCE?

For purposes of Section 129 testing, the proposal would use the definition of highly compensated employee under Internal Revenue Code Section 414(q). In general, that is an employee that received more than \$160,000 in compensation in the prior year or is in the top 20% of employees ranked by compensation, or an employee that owns more than 5% of the company.

The proposed regulations would also treat employers that are aggregated under Sections 414(b), (c), (m), or (o) as a single employer for Section 129 purposes. That can be particularly important for employers operating through multiple related entities.

Eligibility and Benefits

A DCAP would need to benefit employees under an eligibility classification that is reasonably based on objective business criteria and does not discriminate in favor of HCEs or their dependents. An employee would be considered eligible only if the employee has a meaningful opportunity to receive benefits, whether through salary reduction or another funding mechanism. Actual receipt of benefits would not be required for purposes of determining eligibility. Employers using different eligibility rules for different employee groups should pay particular attention to this portion of the proposal.

Average NHCE benefits must be at least 55% of average HCE benefits.

Significantly, the calculation is based on employees who actually received a benefit greater than zero during the plan year, rather than every employee who was merely eligible for the DCAP. Salary reduction benefits would be included in the calculation.

The test would be performed as of the last day of the plan year and would consider relevant employees who received benefits during the year, even if they were employed for only part of the year.

Certain employees may be excluded from testing under statutory rules, including employees who have not reached age 21 and completed one year of service and certain collectively bargained employees.

Proposed Correction Method Could Help Employers Address Failed Tests

The proposal includes important administrative development for employers whose DCAP fails the nondiscrimination test. The proposed regulations would permit employers to correct certain failures through income inclusion.

For example, when the average benefits test fails, an employer could generally include an appropriate amount of excess benefits in affected HCEs' gross income. The correction would have to occur by the deadline for furnishing Forms W-2 for the year in which the benefits were provided.

The proposal provides a similar correction mechanism for a DCAP that fails the 25% owner concentration test.

This could give employers a clearer process for addressing year-end testing failures, although employers would still need accurate census, compensation, participation, ownership, and benefit data to calculate the appropriate correction.

When Would the Proposed Rules Apply?

Treasury and the IRS propose that the regulations apply to plan years beginning on or after the date final regulations are published in the Federal Register. However, taxpayers may rely on the proposed regulations for plan years beginning before final regulations are published.

Comments on the proposed regulations are due Sept. 25, 2026, and the IRS has scheduled a public hearing for Oct. 15, 2026.

Employer Action Items

Employers should consider the proposal from two perspectives: whether a Trump Account contribution program could become part of their benefits strategy and whether existing dependent care programs are prepared for the proposed nondiscrimination framework.

- **Evaluate Trump Account contributions before implementation.** Employers interested in offering contributions should review the written plan, annual contribution limit, nondiscrimination, trustee notifications, payroll, and reporting requirements before launching a program.
- **Coordinate with cafeteria plan administrators.** Employers considering salary reduction contributions to dependents' Trump Accounts should determine whether their Section 125 plan and administrative systems could support the benefit and required election changes.
- **Plan for multiple Trump Account trustees.** The proposal would not permit employers to restrict contributions to accounts held by selected trustees, which could create additional payroll and administrative complexity.
- **Review DCAP testing procedures.** Employers sponsoring dependent care FSAs should confirm that their administrators can perform the eligibility, average benefits, and owner concentration tests using the methodology contemplated by the proposal.
- **Identify HCEs and related employers correctly.** Because the proposal uses the Section 414(q) HCE definition and applies employer aggregation principles, accurate workforce and controlled-group data will be important.
- **Consider testing before year-end.** Although the proposed average benefits test is determined as of the last day of the plan year, preliminary testing may help employers identify potential failures while there is still time to evaluate available options.
- **Monitor the final regulations.** The rules are not yet final. Employers and plan administrators should monitor Treasury and IRS guidance before making long-term administrative or plan-design decisions based solely on the proposal.

New Guidance Regarding Health-Contingent Wellness Programs

The Departments of Labor (DOL), Health and Human Services (HHS), and the Treasury (collectively, the Departments) issued new FAQs addressing health-contingent wellness programs, including programs that impose tobacco-related premium surcharges.

The guidance provides important enforcement relief concerning when a wellness reward must be provided after an individual completes a reasonable alternative standard.

[Health-contingent wellness](#) programs require participants to satisfy a standard related to a health factor to receive a reward, such as a premium discount or avoidance of a surcharge. These programs may be activity-only, requiring completion of an activity, or outcome-based, requiring an individual to attain or maintain a particular health outcome.

Federal rules permit these programs when specific requirements are satisfied. Among other requirements, programs must be reasonably designed to promote health or prevent disease, comply with applicable limits on rewards, and offer reasonable alternative standards when required.

For outcome-based programs, a reasonable alternative generally must be available to any individual who does not satisfy the initial health-related standard.

New Relief on the Timing of Rewards

The new FAQs address when a participant must receive a reward after completing a reasonable alternative standard.

Previous guidance established that an individual who satisfies a reasonable alternative must be able to receive the full reward available under the program. However, the Departments now explain that the regulations do not clearly require the reward to be applied retroactively to the beginning of the plan year when the alternative is completed later in the year.

Until additional guidance or regulations are issued, the Departments will not take enforcement action solely because a plan provides the reward prospectively from the date the participant completes the reasonable alternative, rather than retroactively for the entire plan year.

For example, if an employee is subject to a tobacco premium surcharge but completes the plan's qualifying tobacco cessation program during the year, the plan may generally apply the corresponding reward prospectively under the enforcement policy described in the FAQs.

Disclosure Requirements Continue to Apply

The guidance also reinforces existing notice requirements. Materials describing the terms of a health-contingent wellness program must disclose the availability of a reasonable alternative standard.

For outcome-based programs, this information must also be provided when an individual is notified that they did not satisfy the initial standard. Required disclosures include contact information for obtaining a reasonable alternative and a statement that recommendations from the individual's personal physician will be accommodated.

The existing incentive limits remain unchanged. Generally, health-contingent wellness rewards may not exceed 30% of the cost of applicable coverage, increasing to 50% for programs designed to prevent or reduce tobacco use.

Employer Action Items

- Review tobacco surcharges and other wellness incentives to determine whether they are subject to the health-contingent wellness program requirements.
- Confirm reasonable alternatives are available when required and that participants have sufficient time to complete them.
- Review the timing of rewards for employees who complete reasonable alternative standards during the plan year.
- Audit employee communications to ensure required reasonable alternative disclosures are included.
- Coordinate with carriers, TPAs, wellness vendors, and payroll providers to confirm that incentives and surcharges are administered consistently with plan terms.
- Review plan design and administrative practices to ensure continued compliance with existing HIPAA nondiscrimination and wellness program requirements.

Massachusetts Announces Guidance on PFML Tax Treatment

Massachusetts employers have new guidance on the [tax treatment](#) of benefits under the state's Paid Family and Medical Leave (PFML) program. The Massachusetts Department of Family and Medical Leave (DFML) has clarified how PFML benefits will be treated in 2026 and how a recent legislative change will affect the program beginning in 2027.

What Applies in 2026?

For calendar year 2026, Massachusetts employers will not face new withholding or reporting obligations for PFML benefit payments. DFML will not treat medical leave benefits as third-party sick pay, and employers will not have additional FICA or FUTA responsibilities for those benefits.

The tax treatment for employees depends on the type of leave and, for medical leave, employer size:

- Medical leave
 - For employers with 25 or more employees, 60% of the benefit is treated as taxable for federal and Massachusetts income tax purposes.
 - For employers with fewer than 25 employees, the benefit is not treated as taxable.
- Family leave
 - 100% of the benefit is treated as taxable for federal and Massachusetts income tax purposes, regardless of employer size.

Massachusetts DFML will report the applicable taxable benefit amounts directly to employees on Form 1099-G. Employees may elect federal and state income tax withholding from taxable PFML benefits.

What Applies in 2027?

Massachusetts has also enacted legislation designed to mitigate the effect of the federal tax rules beginning in 2027.

Under the new structure, employers will no longer make contributions toward medical leave. Instead, medical leave contributions may be funded entirely through employee withholding. Because medical benefits will no longer be attributable to employer medical leave contributions, Massachusetts states that medical leave benefits will not be taxed as wages under the federal framework.

The legislation shifts employer funding to the family leave portion of the program. Massachusetts will establish the applicable 2027 contribution rate by Oct. 1, 2026, with the new contribution structure taking effect Jan. 1, 2027.

Employer Action Items

Employers should continue following existing Massachusetts PFML payroll and reporting procedures during 2026. Employers should also communicate carefully with employees about PFML taxation, since family and medical leave benefits can receive different tax treatment.

Looking ahead, employers should prepare payroll systems and employee communications for the Jan. 1, 2027, contribution changes and watch for Massachusetts to announce the 2027 PFML contribution rate by Oct. 1, 2026. Employers using an approved private PFML plan should separately review the tax treatment applicable to benefits under their arrangement.

California's Restructured MCO Tax Expected to Increase Group Health Plan Premiums

California employers offering fully insured group health coverage could face additional premium pressure beginning in 2027 as the state restructures its Managed Care Organization (MCO) tax.

California's existing MCO tax applies to health plan enrollment and helps finance the Medi-Cal program. Under the current structure, Medi-Cal enrollment is taxed at a substantially higher rate than commercial enrollment. The 2025 tax was approximately \$274 per month for Medi-Cal enrollment compared with \$2 per month for commercial enrollment.

Federal changes, however, prevent California from continuing this highly disproportionate tax structure. The California Department of Health Care Services (DHCS) has confirmed that the current MCO tax remains authorized through Dec. 31, 2026, and will no longer have federal approval after that date.

What's Changed?

California's 2026-27 budget and related DHCS actions restructure the MCO tax to generate additional revenue from commercial health plans while complying with federal rules.

- Flat rate: The restructured MCO tax will be a uniform \$8.85 per enrollee per month across Medi-Cal managed care, commercial HMO enrollment, and ACA marketplace plans for 2027-2029.
- Effective date: The new structure takes effect Jan. 1, 2027, or upon federal approval, whichever is later.

DHCS has indicated the alternative structure is designed to generate roughly \$2.3 billion to support Medi-Cal. This matters to employers because taxes imposed on commercial insurers can ultimately be reflected in the premiums those insurers charge their customers.

Unlike the tax imposed on Medi-Cal enrollment, which is effectively offset through Medi-Cal payments, the commercial portion of the MCO tax represents a cost to health plans, which may recover some of that expense through higher premiums.

The California Association of Health Plans (CAHP) estimates the impact at roughly \$100 per covered person per year if fully passed through. Actual 2027 premium impact will depend on plan type (HMO vs. PPO), market segment (small vs. large group), and whether carriers absorb part of the cost.

Which Employer Plans May Be Most Affected?

The most direct impact is expected to fall on employers purchasing fully insured HMO coverage from California health plans subject to the tax. Those employers could see the additional cost incorporated into future renewal rates or applied as a separate adjustment.

The impact on self-funded employer health plans is different because the employer generally bears its own claims risk rather than purchasing insured coverage. The tax is imposed on health plans rather than directly on employer plan sponsors. Employers should therefore avoid assuming that the projected premium impact for the insured market applies equally to self-funded arrangements.

Employer Action Items

- California employers should factor the restructured MCO tax into 2027 health plan budgeting and renewal discussions, particularly if they sponsor fully insured coverage.
- Ask carriers and brokers whether the new tax is reflected in 2027 renewal projections and, where possible, request that the tax-related component be identified separately from medical trend, utilization, prescription drug costs, and other factors affecting premiums. Key questions include:
 - Is the \$8.85 PMPM MCO tax included in the quoted 2027 rates?
 - If not included, how and when will it be applied (separate line item, mid-year adjustment, etc.)?
 - Does the treatment differ by product (HMO/PPO), funding type (fully insured vs. flex-funded), or market segment (small vs. large group)?
- Employers considering alternative funding arrangements because of rising premiums should evaluate those options carefully. Moving from fully insured to self-funded coverage involves changes in financial risk, stop-loss coverage, administration, and compliance obligations and should not be evaluated solely as a strategy for avoiding the impact of the MCO tax.

ACA Affordability Threshold and Penalties Increase in 2027

Applicable large employers (ALEs) will have more flexibility when determining whether their health coverage is considered affordable under the Affordable Care Act (ACA) in 2027. The IRS has announced that the [ACA affordability percentage](#) will increase to 10.22% for plan years beginning in 2027, up from 9.96% for 2026.

The higher percentage may allow employers to require employees to pay a larger share of the premium for self-only coverage while still satisfying the ACA affordability requirement.

Why Affordability Matters

The ACA's employer shared responsibility provisions generally apply to ALEs—employers that averaged at least 50 full-time employees, including full-time equivalents, during the preceding calendar year.

ALEs generally must offer minimum essential coverage to at least 95% of their full-time employees and their dependents. To avoid potential penalties, the coverage offered to full-time employees must also be affordable and provide minimum value. A plan generally provides minimum value when it covers at least 60% of the expected total allowed cost of benefits and satisfies applicable minimum-value requirements.

For affordability purposes, the employee's required contribution is generally based on the lowest-cost self-only coverage option that provides minimum value and is available to that employee.

Three Affordability Safe Harbors

Because employers generally do not know an employee's household income, ACA regulations provide three optional safe harbors. For 2027, employers can apply the 10.22% affordability percentage to one of these measures:

1. Federal Poverty Line (FPL) Safe Harbor: Coverage is affordable if the employee's required monthly contribution does not exceed 10.22% of the applicable federal poverty line for a single individual, divided by 12.
2. Rate of Pay Safe Harbor: Affordability is generally determined using the employee's hourly rate of pay or monthly salary and applying the 10.22% threshold under the regulatory rules.
3. Form W-2 Safe Harbor: The employee's required contribution generally cannot exceed 10.22% of the employee's Box 1 Form W-2 wages from that employer, subject to the applicable rules for partial-year employment and coverage.

Employers may use different safe harbors for different reasonable categories of employees as long as a safe harbor is applied uniformly and consistently within each category.

2027 ACA Penalties Also Increase

The IRS has also announced higher employer shared responsibility payment amounts for 2027.

- Section 4980H(a) penalty: \$3,780 annually
- Section 4980H(b) penalty: \$5,670 annually

The Section 4980H(a) penalty may apply when an ALE fails to offer minimum essential coverage to at least 95% of its full-time employees and their dependents and at least one full-time employee receives a Marketplace

premium tax credit. The penalty generally applies to the employer's full-time employee population, subject to the statutory 30-employee reduction and other applicable rules.

The Section 4980H(b) penalty may apply when an ALE satisfies the 95% offer requirement, but one or more full-time employees receive a premium tax credit because, for example, the coverage offered to them was unaffordable or failed to provide minimum value. This penalty generally applies only for each full-time employee who receives a premium tax credit and is capped so that it cannot exceed the applicable Section 4980H(a) penalty. Both penalties are calculated monthly even though the IRS publishes annual amounts.

Employer Action Items

- Update affordability calculations to 10.22% for plan years beginning in 2027.
- Determine which safe harbor will be used and verify that payroll and benefits data support the calculation.
- Review the lowest-cost self-only option providing minimum value, since that coverage is generally used for employer affordability testing.
- Model employee contributions before open enrollment, particularly when increasing employee premium shares.
- Remember that affordability alone is not enough. ALEs must also consider the ACA's 95% offer requirement, dependent coverage requirement, minimum value rules, and Forms 1094-C and 1095-C reporting requirements.
- Be aware of the increased penalty exposure. For 2027, the indexed Section 4980H(a) and (b) penalty amounts rise to \$3,780 and \$5,670, respectively.

Question of the Month | HSA and Telemedicine

Q. For 2027, is telemedicine still allowed to be a \$0 copay on HSA/HDHP plans?

A. Yes, the One Big Beautiful Bill made the telehealth safe harbor permanent. Employers are free to offer no-cost telehealth services as part of an HDHP without jeopardizing the ability to make HSA contributions.

Answers to the Question of the Week are provided by Kutak Rock.

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