



Non-Discrimination Provision Expansion

BenefitMall would like to inform you that the Patient Protection and Affordable Care Act (PPACA) amended the Internal Revenue Code (IRC) to expand a non-discrimination provision that once applied only to self-funded health plans – now the requirement applies to fully-insured health plans as well.

With the new requirement, an employer sponsoring a fully-insured health benefit plan, or the plan itself, must not discriminate in favor of highly compensated employees by offering them additional coverage or benefits at more affordable rates compared to the other employees covered by the plan. Effective for plan years beginning on or after September 23, 2010, the non-discrimination provision associated with Section 105(h) of the IRC now applies to both self-funded and fully-insured health plans. However, "grandfathered," fully-insured plans will not be subject to the expanded non-discrimination rule.

Background

The applicable provision in the health care reform law reads:

SEC. 2716. PROHIBITION OF DISCRIMINATION BASED ON SALARY.

(a) IN GENERAL – The plan sponsor of a group health plan (other than a self-insured plan) may not establish rules relating to the health insurance coverage eligibility (including continued eligibility) of any full-time employee under the terms of the plan that are based on the total hourly or annual salary of the employee or otherwise establish eligibility rules that have the effect of discriminating in favor of higher wage employees.¹

The Internal Revenue Service (IRS) permits employers to offer certain health plan benefits on a tax-exempt basis as long as certain regulations are followed. If the plan discriminates in favor of highly compensated individuals, the tax exempt provision can be disallowed if certain tests are not met and a penalty may be assessed against the employer who is sponsoring or underwriting the plan.

The new health care reform law promotes a more level playing field in how employer-sponsored health insurance is offered to employees. As a result, the expanded non-discrimination requirement creates a significant chilling effect on fully-insured, executive medical plans where senior executives would have access to higher level benefits or reduced cost-sharing arrangements.

Scope

Generally, the regulations issued pursuant to Section 105(h) apply to employer-sponsored health benefit plans that cover premiums and expenses for qualified medical and other specialty plans.² The recent amendments expand the non-discrimination provisions to health benefit plans irrespective of whether they are fully-insured, self-funded, or medical reimbursement plans. Some types of plans are excluded from the new requirements, including "grandfathered" plans, government-sponsored health plans and limited benefit plans.

Eligibility & Benefit Tests

PPACA provides that non-grandfathered, fully-insured plans must satisfy the Section 105 requirements, which prohibit discrimination in favor of highly compensated individuals. To satisfy the non-discrimination rules, health plans must pass several

tests.

To pass the "eligibility" test, a plan must benefit one of the following:

- At least 70 percent of all employees;
- At least 80 percent of all employees who are eligible for benefits under the plan (if at least 70 percent of all employees are eligible to participate in the plan); or
- A nondiscriminatory classification of employees.

In running the eligibility test pursuant to IRC subsection 501(h)3, an employer may exclude employees that:

- Have three years or less of service at the company;
- Are younger than age 25;
- Are part-time or seasonal (less than 35 hours per week);
- Are part of a collectively-bargained arrangement; or
- Are non-resident aliens who do not receive U.S. earned income.

In addition, the "benefits" provided under the health plan must not discriminate in favor of highly compensated individuals. The health plan should incorporate several design features in order to be non-discriminatory. For example, plans should:

1. Establish parity in employee contributions for each benefit level;
2. Preclude offering lower co-pays for highly compensated employees; and
3. Not impose different waiting periods.

The employer sponsoring the health plan also must not discriminate in favor of highly-compensated individuals in actual operation. For example, discrimination in operation could arise if a plan administrator approves certain claims for medical expenses under the utilization management process for highly compensated employees while denying them for lower compensated employees.

For purposes of IRC subsection 105(h)(5), the term "highly compensated individual" means an individual who is:

1. One of the five highest paid officers;
2. A shareholder who owns more than 10 percent in value of the stock of the employer; or
3. Is among the highest paid 25 percent of all employees.

Additional Guidance

The IRS recently requested comments on how to apply this extension of the non-discrimination rules to fully-insured plans.³ Therefore, it is likely that additional insights detailing the new non-discrimination requirements for fully-insured plans will be forthcoming. Experts note the new rules most likely will be similar to the self-funded plan, non-discrimination requirements.⁴

Penalties

In its request, the IRS also clarified that the penalty for failure of fully-insured plans to meet the non-discrimination rules will be the imposition of an excise tax on the plan's sponsoring employer in the amount of \$100 per day for each individual against whom the plan discriminates. In other words, the fee will apply on a daily basis for each employee that is not highly compensated and who does not receive the discriminatory benefit. Therefore the employer will be subject to a \$100 per day, per participant excise tax or civil money penalty, which is capped at the lesser of \$500,000 or 10 percent of the employer's health care expenses for the previous year. The IRS notice also comments that "the plan is subject to a civil action to compel it to provide nondiscriminatory benefits" to the individual discriminated against. No penalties will be assessed against a plan if reasonable due diligence would not have discovered the noncompliance and/or the failure was due to a reasonable cause and was corrected within 30 days.

Next Steps

Plans sponsors should begin to review the design elements of their existing coverage offerings to assess whether:

1. The plan is covered by the new IRS requirements; and
2. If any changes need to be made in order not to run afoul of the new non-discrimination requirements for fully-insured health offerings.

Interested parties should monitor future IRS bulletins that provide additional guidance on the matter, and plans sponsors should secure input from tax or benefit experts before making any changes.

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In order for you to conveniently share this information with your clients, please view the fillable document, [Non-Discrimination Provision Expansion](#).

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Sincerely,



Michael Gomes
Executive Vice President

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1. PL 111-148 enacted on March 23, 2010 (See also PL 111-152 enacted on March 30, 2010).
2. PPACA does not literally extend section 105(h) of the IRC to fully-insured plans. The new law adds section 2716 to the Public Health Services Act ("PHSA"), which provides that insured plans must satisfy the requirements of section 105(h).
3. See IRS Notice: 2010-63 (<http://www.irs.gov/pub/irs-drop/n-10-63.pdf>)
4. However, the penalty provisions will likely differ between self-funded and fully-insured plans.

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