

Health Care Reform: Non Discrimination Rules

The Patient Protection and Affordable Care Act (PPACA) requires fully insured health plans to meet rules regarding nondiscrimination. Previously, these requirements applied only to self-insured plans.

What are the nondiscrimination testing requirements?

Insured group health plans may not discriminate in favor of highly compensated employees under the Internal Revenue Code Section 105(h). This provision previously applied to self-funded plans only but will apply to fully insured non-grandfathered plans as well, following future issuance of specific guidance on the rules' application to insured plans. These "insured plan" nondiscrimination rules do not apply to grandfathered plans or policies that satisfy the grandfather interim final rule.

How do the new PPACA changes, relating to the application of the 105(h) rules to fully insured plans, apply to plans offered by an employer to two different classes of employees (e.g., hourly and salaried)?

Section 105(h) of the Internal Revenue Code (IRC) establishes criteria under which plans may be considered to be discriminatory in favor of "highly compensated" individuals.

There are two areas of discrimination:

1. Eligibility for benefits, and
2. Benefits provided.

The term "highly compensated" means:

1. One of five of the highest paid officers,
2. A shareholder who owns 10% in value of stock of the employer, and
3. An employee among the highest paid 25% of all employees.

The term "employee" for purposes of the eligibility test excludes those employees who have not completed 3 years of service, who have not attained the age of 25, are part-time or seasonal, non-resident aliens, and employees who are members of a collective bargaining unit that has bargained in good faith with respect to benefits provided under the Plan.

In the case of fully insured plans, the nondiscrimination rules are enforced through the imposition of an excise tax of **\$100 per day per individual** discriminated against under IRC 4980D(d). Other penalties may also apply for non-compliance with PPACA, such as civil money penalties up to \$100 per day per failure.

Does the excise tax penalty of \$100 a day apply to small groups with less than 51 employees?

It appears that the penalty does not apply to small groups if the failure to comply with the rule is

“solely because of the health insurance coverage offered by the issuer.” It is unclear, however, if small employer groups are subject to the \$100 a day penalty if they make eligibility or contribution determinations that result in discrimination in favor of highly compensated employees as defined in the law.

Does the prohibition on salary discrimination apply to both self-insured and insured group health plans?

Under existing law, self-insured group health plans are already subject to the nondiscrimination requirements set forth in §105(h)(2) of the Internal Revenue Code. This provision of the health care reform law expands this prohibition to include insured group health plans, with further details to be provided presumably through regulatory guidance.

Who is considered a “higher wage employee” for purposes of the non-discrimination provision?

The ACA does not define who is considered a higher wage employee for purposes of this provision. However, in the self-funded context, a highly compensated individual is generally defined as: (1) one of the five highest paid officers; (2) a shareholder who owns more than 10 percent of the stock of the employer; or (3) among the highest paid 25 percent of all employees. (See §105(h)(5) of the Internal Revenue Code)

How exactly will the non-discrimination rules be applied to insured non-grandfathered group health plans?

Currently, there are specific and complex non-discrimination testing rules that plan sponsors use to determine if their self-funded group health plan is discriminatory as to benefits or eligibility in favor of highly compensated employees based on IRS formulas. These formulas currently take into account part-time employees in determining whether a plan discriminates in favor of highly compensated employees. Since this is a new provision with respect to insured group plans, it is unclear how the non-discrimination rules will be applied, and we expect federal agencies to issue regulations on eligibility and benefits testing in the future.

When do these penalties begin?

PPACA stated that the 105(h) rules would apply to nongrandfathered fully insured group health plans on their first plan year on or after September 23, 2010. On December 22, 2010, however, the IRS (with the support of the Departments of Labor and HHS) announced that compliance with the rules will not be required of insured plans until guidance is provided regarding their application. Until that time, sanctions for failure to comply with the rules will not apply. Furthermore, the agencies expect that when such guidance is issued, its effective date will be delayed until plan years beginning a certain time after issuance.