



Benefit Trends

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Health Care Reform – Special Edition

Health Care Reform: Non-discrimination Testing for Insured Plans- Revised

LEGISLATIVE BRIEF

April 29, 2010 (Revised July 15, 2010)

This memorandum is a revision to the fourth installment in our effort to address the critical and imminent changes brought about by the Patient Protection and Affordable Care Act ([H.R. 3590](#); Reform Bill) and the Health Care and Education and Affordability Reconciliation Act ([H.R. 4872](#); Reconciliation Bill), collectively referred to as the Health Care Reform Bills.

The BIG Change

For plan years beginning on or after September 23, 2010, insured health plans will be subject to the non-discrimination rules contained in the Internal Revenue Code Section 105(h) prohibiting a group health plan from discriminating in favor of highly compensated employees as to eligibility to participate in a plan or to the benefits provided under the plan. Please refer to the Attachment for a copy of the actual HCR provision. This new rule will not apply to grandfathered plans until and at such time the plan loses its grandfathered status (e.g. due to a change in plan design).

Past Practices

Historically, a number of employers purchased a special group health policy covering the employer's executive staff only. The policy provided benefits supplementing the underlying group health plan by covering deductibles, co-pays, and excess over plan limits, as well as qualifying benefits not available through the basic health (including dental and vision) plans.

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Non-highly compensated employees typically would be ineligible to participate in the plan. Since insured group health plans were exempt from the discrimination testing rules applicable to self-funded plans, the policy could be limited to executives without IRS scrutiny.

Other Impacts

This new rule also may impact multi-state employers who have different benefit levels, eligibility rules, and contribution requirements based on business location. For example, a company based in Connecticut may have a rich health plan with no employee contributions for Connecticut employees and a plant in California with a modest health plan and high employee contributions achieving parity with what California employers offer as benefits in the same industry. The non-discrimination testing rules may require a more uniform level of benefits and contributions for all employees regardless of their business location, although there is some latitude here.

The Rule

The Health Care Reform law will require plan sponsors to maintain insured group health plans (e.g. Kaiser, Health Net, etc.) that do not discriminate in favor of highly compensated individuals. It appears that each carrier contract is to be tested separately, for the most part. The Health Care Reform Law relies on the non-discrimination tests found in [Section 105\(h\)](#) of the Internal Revenue Code (IRC), paragraphs (3), (4), and (8):

The Tests	
105(h)(3)	Non-discriminatory eligibility classification
105(h)(4)	Non-discriminatory benefits
105(h)(8)	Controlled groups, etc.

It deviates from IRC Section 105(h) when it comes to the penalties/excise taxes applicable to the discriminatory plan. Under the Health Care Reform Law, the employer will be subject to a \$100 per day/per affected participant excise tax under Section 4980D for a failure to satisfy the non-discrimination requirements. Section 2722 of the PHSA also gives the Secretary of HHS the discretion to impose a civil penalty on employers of up to \$100 per day/per affected participant for certain violations. The DOL has enforcement power of violations of the discrimination rules. The maximum excise tax under Section 4980D for unintentional failures is \$500,000 per taxable year.

The Eligibility Tests

A plan satisfies the eligibility requirements if the plan is available to:

1. 70% or more of all employees, or to
2. 80% or more of all the employees who are eligible to benefit under the plan if 70% or more of all employees elect to participate in the plan.

Alternatively, a plan meets the eligibility requirements if it covers a classification of employees that does not discriminate in favor of highly compensated individuals. The 80/70 percentage test requires a minimum of 56% of employees (80% multiplied by 70%) participating in the plan. The non-discriminatory classifications test will allow reasonable classifications generally including specified job categories, compensation categories such as hourly or salaried, geographic location to some extent, and similar bona fide business criteria.

Certain non-participating employees may be excluded from the eligibility tests, including employees who have not completed three years of service; employees younger than age

25; part-time or seasonal employees; union employees; and employees who are nonresident aliens and who receive no U.S. earned income.

The Benefits Test

In addition to the eligibility rules, all benefits provided to highly compensated employees must be provided to all other participants.

Please note: the controlled group rules specify that employees of controlled groups of corporations and partnerships and employees of affiliated service groups are to be treated as employees of a single employer.

Definition of Highly Compensated

Using the same definition as for self-funded plans, a highly compensated individual is defined as one of the five highest paid officers, a shareholder who owns more than 10% in value of the stock of the employer, or among the highest paid 25% of all employees.

Action Plan

1. If you are currently a grandfathered plan and if you are considering changes to your plan now or at the time of the policy renewal, and, if you have an executive type health plan or are a multi-state employer, seek the advice of your benefit plan consultant regarding the risk of failing the IRC Section 105(h) plan discrimination testing rules. The rule becomes applicable to your plan upon the implementation of the plan change or for plan years beginning on or after September 23, 2010, whichever is later.
2. If you do not have an executive type health plan and if you offer the same benefits to all employees with the same employee contribution requirements, and if you are considering a change in plan, weigh the value of the change against the risk of becoming subject to the discrimination testing rules.
3. Watch for further official guidance.
4. Contact your benefits consultant with any questions.

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Discrimination Testing

H.R. 3590

'SEC. 2716. PROHIBITION ON DISCRIMINATION IN FAVOR OF HIGHLY COMPENSATED INDIVIDUALS.

`(a) In General- A group health plan (other than a self-insured plan) shall satisfy the requirements of section 105(h)(2) of the Internal Revenue Code of 1986 (relating to prohibition on discrimination in favor of highly compensated individuals).

`(b) Rules and Definitions- For purposes of this section--

`(1) CERTAIN RULES TO APPLY- Rules similar to the rules contained in paragraphs (3), (4), and (8) of section 105(h) of such Code shall apply.

`(2) HIGHLY COMPENSATED INDIVIDUAL- The term `highly compensated individual' has the meaning given such term by section 105(h)(5) of such Code.'.

