

Expansion of Non-Discrimination Rules to Insured Benefits in the Patient Protection and Affordable Care Act

Among the many health insurance and benefits law changes made by the Patient Protection and Affordable Care Act (PPACA, P.L. 111-148) is a new requirement for fully insured health/medical plans to comply with nondiscrimination benefit rules that previously only applied to self-funded employer plans.

Effective for plan years beginning on or after September 23, 2010, fully insured group health plans now must comply with the nondiscrimination requirements for self-funded plans, including rules that the plan does not discriminate in favor of highly compensated individuals as to eligibility to participate. In addition, the benefits provided under the plan may not discriminate in favor of participants who are highly compensated individuals.¹ This does NOT apply to “grandfathered” health plans.

Though compliance regulations are expected from the Department of Labor, IRS and other federal agencies, rules similar to those for self-funded plans are expected to be applied to insured group health plans, including rules for eligibility, benefits, and controlled groups. Unlike discriminatory self-insured plans, for which highly compensated employees get taxed, the PPACA does not tax highly compensated employees covered by discriminatory fully-insured plans. It appears likely that the tax consequence of any violations would be similar to the HIPAA group health plan \$100/day excise tax, not taxation of benefits.

The PPACA, Sec. 1001 as amended by Sec. 10101 (new Public Health Service Act Sec. 2716) provides that a group health plan shall satisfy the requirements of section 105(h)(2) of the Internal Revenue Code (relating to prohibition on discrimination in favor of highly compensated individuals). Rules similar to the rules contained in paragraphs (3), (4), and (8) of section 105(h) of the Code shall apply, and the term “highly compensated individual” has the meaning given such term by section 105(h)(5).

Non-Discrimination Rules and IRC Sec. 105(h) for Self-Insured Plans

Internal Revenue Code (IRC) Sec. 105 and Sec. 106 permit employers to offer certain health benefits on a tax-free basis. However, these rules can be different for highly compensated employees (HCEs) if the health plan is self-insured and eligibility for benefits or benefits payable to the HCE is discriminatory. For purposes of IRC Sec. 105(h), an HCE (determined in the plan year for which the reimbursement was made) is:

- One of the five highest-paid officers;
- A shareholder owning (actually or constructively) more than 10 percent of the company’s stock;
- Among the highest paid 25 percent of all employees.

These requirements are not mutually exclusive. The five highest paid officers may also be among the highest paid 25% of all employees. However, if one of the top five officers is not in that pay range, that officer still needs to be included in the highly compensated individual category.

IRC Sec. 105(h) applies to all employment-based health plans (medical, dental, and vision) in which the risk has not been shifted to an insurance company, including administrative services only (ASO) and cost-plus arrangements, possibly minimum premium plans, and medical reimbursement plans provided through an IRC Sec. 125 plan (collectively referred to as “self-insured health plans”).

¹ Sec. 1001 of the PPACA as amended by Sec. 10101; new Sec. 2716 of the Public Health Service Act

If such a self-insured health plan discriminates in favor of HCEs, the affected HCEs must include some or all of the value of the benefits received in their taxable income. This imputed income is subject to federal income taxes (but not to Social Security or Medicare taxes), and state tax liability if such liability is calculated pursuant to federal rules.

Eligibility Test—For a plan to be considered nondiscriminatory with respect to eligibility to participate, it must pass one of the three coverage tests:

- Seventy percent of all employees benefit under the plan;
- The plan benefits 80 percent of eligible employees and 70 percent of all employees are eligible;
- The plan benefits a nondiscriminatory classification of employees.

The IRS regulations indicate that the plan must provide the same benefits for both highly compensated and non-highly compensated employees. If a plan provides different benefits to different groups of employees (e.g., differences in waiting periods), each benefit structure is treated as a separate plan for purposes of the eligibility test described above.

A self-insured health plan discriminates as to benefits unless all benefits provided for participants who are HCEs are also provided to all other participants. All benefits for dependents of HCEs must also be available on the same basis for the dependents of all other employees. The self-insured health plan will also be considered discriminatory as to benefits if it covers HCEs and the type or amount of benefits subject to reimbursement is offered in proportion to compensation. The nondiscrimination test is applied to the benefits subject to reimbursement under the medical program and not to the actual payments or claims made. Further, a self-insured plan is not considered discriminatory just because HCEs utilize benefits to a greater extent than other participants.

If there are optional benefits available (e.g., vision and dental), these benefits will also be considered nondiscriminatory if all eligible employees can elect any of the benefits and either there is no required premium by the employee or the premium charged is the same for all employees.

Certain employees may be excluded from the eligibility tests, including:

- Those who have less than three years of service at the beginning of the plan year;
- Those who are younger than age 25 at the beginning of the plan year;
- Part-time or seasonal employees;
- Those who are covered under a collective bargaining agreement;
- Nonresident aliens who receive no income from a U.S. source.

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

Since the discrimination rules for self-funded plans were issued in 1980, employers have adopted fully insured plans to provide executives and key employees with tax-free reimbursements for out-of-pocket medical, dental, and vision expenses. The new PPACA prohibitions against discrimination in fully insured plans will compel employers to consider other methods in compensating higher earning employees.