

Health Plan Non-Discrimination Rules

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I. Code §105(h)

A. General Rule: Prohibits discrimination as to eligibility or benefits in favor of any highly compensated individuals in a self-insured medical expense reimbursement plan.

1. Statute effective January 1, 1980
2. Regulations §1.105(h)-11 (1981)
3. A few PLRs from early 1980's

B. Highly compensated individual ("HCI")

1. 5 highest paid officers
2. 10% shareholder
3. Highest paid 25% of all employees

C. Eligibility Test

1. Plan must pass one of three tests
 - a. 70% of all employees benefit
 - b. 80% of all eligible employees benefit if at least 70% of all employees are eligible
 - c. Reasonable classification test [reference in regulations is to Code §410(b)(1)(B), the old "fair cross section" test]
 - (i) How to apply current reasonable classification test where HCI definition is different than HCE definition and categories of excludable employees are different?
2. Can exclude from the eligibility test
 - a. Employees with less than 3 years of service
 - b. Employees less than age 25
 - c. Part-time or seasonal employees
 - d. Union employees
 - e. Non-resident aliens
3. Issues
 - a. Will a union plan automatically satisfy the test?
 - b. How does a health FSA satisfy this test?

D. Benefits test

1. All the benefits provided for HCIs must be provided for all other participants
2. Potential issues
 - a. Different waiting period
 - b. Different contribution rates
 - c. Longer employer-paid COBRA following severance

E. Special rules

1. Plan cannot discriminate in operation. Reg. §1.105(h)-11(c)(3)(ii).
2. Retiree plan is separately tested (apparently only a benefits test). Reg. §1.105(h)-11(c)(3)(iii).
3. Plans can be aggregated. Reg. §1.105(h)-11(c)(4).
4. Appears to only apply to employer contributions. Reg. §1.105(h)-11(i).

F. Sanction: HCIs include "excess reimbursements" in income

1. If benefits test is failed: HCI includes the entire discriminatory benefit in income
2. If eligibility test is failed:

$$\begin{array}{r} \text{Amt. reimbursed} \\ \text{to HCI} \end{array} \times \frac{\begin{array}{r} \text{Amt. reimbursed} \\ \text{to all HCIs} \end{array}}{\begin{array}{r} \text{Amt. reimbursed} \\ \text{to all participants} \end{array}}$$

II. §2716 of the Public Health Service Act ("PHSA")

A. General Rule: Non-discrimination rules under Code §105(h)(2) apply to fully insured plans

1. N/A to a grandfathered plan
2. Effective for plan years beginning on or after 9/23/2010
3. Rules "similar to" §105(h)(3) [eligibility test], (4) [benefits test], and (8) [controlled group rules apply] apply
4. HCI definition under §105(h)(5) applies
5. Applicable to ERISA plans under ERISA §715
6. Incorporated into the Internal Revenue Code by Code §9815

B. IRS Notice 2010-63 [September 2010]: Requested comments on how to apply the rules to insured plans.

- C. IRS Notice 2011-1 [late December 2010]: IRS delayed the effective date of PHSA Section 2716 until such time as regulations are issued and requested input on a series of specific questions.
- D. Sanction: Employer can be subject to an excise tax of \$100/day/affected individual under Code §4980D and/or ERISA lawsuit.
1. No tax if failure not discovered after exercising reasonable diligence.
 2. No tax if the failure is due to reasonable cause and corrected within 30 days.
 3. Limit for a single employer plan if failure is due to reasonable cause is the lesser of (a) 10% paid or incurred by the employer during the preceding taxable year for group health plans or (b) \$500,000.
 4. Tax is not imposed on a small employer (less than 50 employees) if the failure is solely because of health insurance offered by a health insurance issuer.
 5. Self report on IRS Form 8928 (not updated for PPACA).