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Healthcare re-FORUM

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Prohibition of Discrimination Based on Salary

Prior to the passage of the Patient Protection and Affordable Care Act (PPACA) and Health Care and Education Reconciliation Act (HCERA), tax rules for fully insured employer-sponsored health plans permitted employers to offer exclusive plans designed for highly compensated individuals on a tax-favored basis. Unlike fully insured business, self-insured plans were prohibited from discriminating in favor of highly compensated individuals. Beginning September 23, 2010, the PPACA and HCERA impose penalties on the plan sponsor for violations of the non-discrimination rules for fully insured plans that are not grandfathered.

Background

Provisions under the new laws now require fully insured plans to comply with non-discrimination rules, which ensure there is no favoritism in eligibility or benefits toward highly compensated individuals. Companies that are affiliated through common ownership may be required to be treated as a single entity for purposes of non-discrimination testing.

Highly Compensated Individuals

For purposes of non-discrimination testing, a highly compensated individual is:

- One of the five highest paid officers
- A shareholder owning more than 10 percent of the company's stock
- Among the top 25 percent of highest-paid employees

These requirements are not mutually exclusive. For example, if one of the five highest-paid officers is not among the 25 percent of highest-paid employees, he or she must still be included as a highly compensated individual.

Discrimination Testing

For a plan to be considered non-discriminatory with respect to eligibility, it must pass one of two coverage tests:

- Under the plan, 70 percent of all employees benefit
- The plan benefits 80 percent of eligible employees if at least 70 percent of all employees are eligible to participate

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

- Employees with less than three years of service at the beginning of the plan year
- Employees who are younger than age 25 at the beginning of the plan year
- Employees who are part-time or seasonal
- Employees who are covered under a collective bargaining agreement
- Non-resident aliens who receive no income from a U.S. source

In addition, the plan benefits must not discriminate based on employee classification (e.g., management vs. non-management). All benefits provided to highly compensated employees must be offered to all participants.

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Penalties for Non-Discrimination

While both fully insured and self-insured plans will now be subject to non-discrimination rules, the penalties for failing to meet these requirements vary by type of plan. Under current law, if a self-insured plan fails to meet non-discrimination requirements, its benefits would become taxable.

The new rules applicable to fully insured plans impose an excise tax on the employer if it fails to meet non-discrimination requirements. The IRS penalty is $100 each day per highly compensated participant. This excise tax for unintentional failures (i.e., the plan sponsor did not know of the violation and would not have discovered the violation) is capped at $500,000 per year. The new law also gives the Secretary of Health and Human Services (HHS) the authority to impose additional civil fines on employers for up to $100 per day for each highly compensated participant in violation of the law.

Applying the Rules to Health Plans

- The new rules do not apply to grandfathered health insurance plans—those in existence on or before March 23, 2010.
- Fully insured plans that are not grandfathered or are established between March 23, 2010, and September 23, 2010, will be subject to the new rules as of the group's first plan year beginning on or after September 23, 2010.
- Fully insured plans established after September 23, 2010, must comply immediately with the new rules.
- The changes a plan can make and still retain grandfathered status have been clarified by the final interim grandfathered plan rules* as released June 14, 2010, by HHS, the IRS and the Department of Labor.
- Grandfathered plans can comply with the new provisions in the PPACA and HCERA without losing their grandfathered status.
- Employers and health insurance issuers are given a grace period up to their next plan year on or after September 23, 2010, during which they can revoke or modify any changes made that caused them to lose their grandfathered status.

Because this provision is highly technical, it is important for employers to work with a tax or benefits lawyer.

*Note: We will provide a summary of the final interim grandfathered plan rules in an upcoming issue of Healthcare Re-Forum.

Future Topics:

- Grandfathered Plans (Updated Regulations)
- National High Risk Pool