

## New Health Care Legislation Expands Nondiscrimination Requirements for Employer-provided Health Insurance

*The imposition of nondiscrimination requirements for insured health plans is among the many changes made by new health care legislation. This HRS Insight highlights these new rules and contrasts them with the existing nondiscrimination requirements that apply to self-insured health plans.*

### Background

On March 23, 2010, the Patient Protection and Affordable Care Act (PPACA) was signed into law. Subsequently, on March 30, 2010, the Health Care and Education Reconciliation Act of 2010 was signed into law, making significant substantive changes to the PPACA. This article refers to the collective, amended legislation as the "Health Care Act."

Lost throughout much of the health care reform debate, with its emphasis on the need for insurance reform and the expansion of coverage for the uninsured, is the fact that employer-provided health benefits are not always provided through the purchase of insurance contracts. Employers either purchase health care insurance from an insurance carrier or self-insure the plan. Under an insured arrangement, the insurance carrier administers the plan and bears the risk of benefit claims. Under a self-insured plan, which may or may not be funded, the employer/plan assumes the risks for paying benefit claims. Insurance carriers frequently perform the role of third-party administrator with responsibility for processing benefit claims.

The value of employer-provided coverage under an insured accident or health policy generally is excludable from an employee's gross income under Section 106. Prior to enactment of the Health Care Act, employer-provided health benefits provided through an insurance contract were not subject to any nondiscrimination requirements. Thus, an employer could provide more generous health insurance benefits to executives through the purchase of individual or group policies.

The rules are different for employer-provided coverage under a self-insured medical reimbursement plan. Under Section 105(h)(2), benefits provided under a self-insured plan are subject to nondiscrimination

requirements. To be excluded from an employee's gross income, uninsured benefits must be provided under an accident and health plan for employees that does not discriminate in favor of highly compensated individuals as to eligibility to participate or benefits.

### Nondiscrimination Requirements in Effect Prior to and Continuing after the Health Care Act

As mentioned above, a self-insured plan may not discriminate in favor of highly compensated individuals either with respect to eligibility to participate or benefits. A plan discriminates as to eligibility to participate unless the plan benefits (1) 70 percent or more of all employees, or 80 percent or more of all the employees who are eligible to benefit under the plan if 70 percent or more of all employees are eligible to benefit under the plan; or (2) such employees qualify under a classification set up by the employer and found by the IRS not to be discriminatory in favor of highly compensated individuals.

In testing for nondiscrimination, certain employees are excluded from consideration, including (1) employees who have not completed three years of service; (2) employees under the age of 25; (3) part-time or seasonal employees; (4) employees covered by a collective bargaining agreement (if health benefits were the subject of good faith bargaining); and (5) employees who are nonresident aliens and who receive no U.S. source income.

**Highly compensated individuals.** Highly compensated individuals are defined under Section 105(h)(5) as the five highest-paid officers, any 10 percent owners (attribution rules apply), and the highest-paid 25 percent of all employees.

**Taxation of excess reimbursements.** "Excess reimbursements" paid to a highly compensated

individual under a discriminatory self-insured medical reimbursement plan are taxable to the individual. Two situations produce an excess reimbursement. For a benefit available to a highly compensated individual but not to other participants, the total amount reimbursed under the plan is taxable. In the case of benefits available to all participants, and not otherwise discriminatory, where the plan discriminates as to participation, excess reimbursement is determined by multiplying the total amount reimbursed to the highly compensated individual for the plan year by a fraction, the numerator of which is the total amount reimbursed to all highly compensated individuals under the plan, and the denominator of which is the total amount reimbursed to employees under the plan for the plan year.

**Physical examinations.** The regulations under Section 105(h) provide an exception from the nondiscrimination requirements for "medical diagnostic procedures." Thus, for example, an employer with a self-insured plan may provide executives with an annual physical exam and it would not be considered discriminatory.

### Nondiscrimination Rules Expanded to Insured Plans

Effective for plan years beginning after September 23, 2010, the Health Care Act amended the Public Health Service Act (PHSA) to impose rules similar to the nondiscrimination requirements of Section 105(h)(2) to insured group health plans. Plans in existence on March 23, 2010, the date of enactment of PPACA, are grandfathered. The Department of Health and Human Services (HHS) has responsibility for interpreting the PHSA.

It is too early to know whether the exception from the nondiscrimination rules for physical exams provided in the regulations under Section 105(h), but not in the Internal Revenue Code (the "Code"), will apply to insured plans.

**Effective date and grandfather rules.** Employer-provided health insurance policies in existence on March 23, 2010 may continue to discriminate in favor of highly compensated employees.

Policies that are purchased after March 23, 2010, and before September 23, 2010, will be subject to nondiscrimination requirements beginning with the first plan year beginning after September 23, 2010. For example, if an employer sets up a new insured plan on May 1, 2010 with an April 30 year end, the insurance contract may discriminate for this first plan year. The

nondiscrimination requirements will kick in on May 1, 2011, which would be the first plan year beginning after September 23, 2010.

An employer that purchases an individual or group health policy on or after September 23, 2010 will be subject to these nondiscrimination requirements.

**Income tax inclusion will not apply to discriminatory insured plans.** While the nondiscrimination rules that currently apply to self-insured plans will apply to insured group health plans, the income tax rules will not. This is because the Health Care Act added nondiscrimination requirements through an amendment to the PHSA and not by expanding Section 105(h) of the Code. The plan administrator will be subject to penalties if the plan fails to comply with the nondiscrimination rules, but highly compensated employees will not be subject to income taxation on excess reimbursements.

Under the Health Care Act, the employer will be subject to a \$100 per day/per affected participant excise tax under Section 4980D for a failure to satisfy the nondiscrimination requirements. The excise tax under Section 4980D applies to employers whose group health plans fail to satisfy the group health plan requirements described in Chapter 100 of the Code. PPACA added to Chapter 100 a new Section 9815, which states that group health plans must satisfy the requirements of "Part A of Title XXVII of the Public Health Service Act" as amended by PPACA. Part A of Title XXVII of the PHSA includes Sections 2701 to 2723, which contain the health care reform provisions concerning lifetime and annual limitations, nondiscrimination rules for insured plans, and the other PPACA provisions that apply to coverage offered under group health plans such as the restriction on pre-existing condition exclusions, the dependent coverage extension to age 26, and the waiting period limitations.

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 violations of Part A of Title XXVII. The provisions of the Health Care Act that are incorporated in Section 9815 also have been added to new Section 715 in Part 7 (Title 1, Subtitle A) of ERISA. The Department of Labor has enforcement power for violations of Part 7.

**Limitations on the Section 4980D excise tax.** The maximum excise tax under Section 4980D for unintentional failures is \$500,000 per taxable year. The tax does not apply if the taxpayer did not know of the violation and would not have discovered the violation by

exercising reasonable diligence, or with respect to an unintentional failure that is corrected within 30 days. Also, the IRS has the discretion to waive the tax in whole or in part to the extent the failure was due to reasonable cause and not to willful neglect. With certain exceptions, small employers (no more than 50 employees) with fully insured plans are not subject to the tax.

**Observation:** *As with many other provisions in the Health Care Act, there are some unanswered questions regarding the application of the new nondiscrimination rules. One such issue that arises is with the notion of a grandfathered plan. Specifically, what constitutes the establishment of a new plan? Currently, it appears that a plan will not lose grandfathered status if new employees (and their dependents) are enrolled in the plan or if employees already enrolled in the plan choose to add their dependents to the plan after March 23, 2010, so long as the plan offered dependent coverage prior to that date. It is unclear, however, whether a plan will lose grandfathered status if structural changes are made to the plan (e.g., a change in insurance carriers). As with so much of the Health Care Act, we anticipate future guidance on this subject.*

For more information on the topic discussed in this *HRS Insight* or to change your address, contact your local PricewaterhouseCoopers professional.

<a href="#">Atlanta, GA</a>	Ann O'Connell	678-419-2820	<a href="#">Los Angeles, CA</a>	Carrie Duarte	213-356-6396
	Charlie Yovino	678-419-1330	<a href="#">New York Metro</a>	John Caplan	646-471-3646
<a href="#">Boston, MA</a>	Ed Donovan	617-530-4722		Ed Donovan	646-471-8855
	Matthew Cowell	617-530-5694		Scott Olsen	646-471-0651
<a href="#">Charlotte, NC</a>	Charlie Yovino	704-344-7739	<a href="#">Philadelphia, PA</a>	Ted Volz	267-330-3180
<a href="#">Chicago, IL</a>	Pat Meyer	312-298-6229		Bruce Clouser	267-330-3194
	Jack Abraham	312-298-2164		Bill Dunn	267-330-6105
	Paul Perry	312-298-3157	<a href="#">San Francisco, CA</a>	Julie Rumberger	408-817-4460
	Terry Richardson	312-298-3717	<a href="#">San Jose, CA</a>	Scott Pollak	408-817-7446
<a href="#">Dallas, TX</a>	Charlie Wheeler	214-754-5023		Julie Rumberger	408-817-4460
<a href="#">Detroit, MI</a>	Theresa Gee	312-298-4700	<a href="#">St. Louis, MO</a>	Terry Richardson	312-298-3717
<a href="#">Houston, TX</a>	Todd Hoffman	713-356-8440	<a href="#">Washington, DC</a>	Jeff Davis	202-414-1857
<a href="#">Kansas City, MO</a>	Terry Richardson	312-298-3717		Nik Shah	703-918-1208

This document is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

SOLICITATION

© 2010 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP (a Delaware limited liability partnership) or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity. \*connectedthinking is a trademark of PricewaterhouseCoopers.