



for your information®

Volume 34 | Issue 01 | January 5, 2011

IRS Delays Application of Nondiscrimination Rules to Insured Group Health Plans

The IRS has delayed the application of the nondiscrimination requirements for fully-insured group health plans, as added by PPACA, until it issues regulations. Because the new rules for fully-insured plans will be based on the existing nondiscrimination rules for self-insured health plan, any new IRS regulations are likely to impact sponsors of both types of plans.

Background

Fully-Insured Plans vs. Self-Insured Plans

An employer-provided health plan that is self-insured by the employer may not discriminate in favor of highly compensated individuals. However, if the employer instead purchases insurance (i.e., fully insures), the plan, even if it is just for executives, has never been subject to nondiscrimination rules. As a result, many employers have used fully-insured plans for part or all of the benefits they provide to higher-paid workers. The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, (jointly PPACA) eliminates this distinction by making fully-insured health plans subject to nondiscrimination rules.

PPACA does this by adding a new Section 2716 to the Public Health Service Act (PHSA) and incorporating the provision into the Internal Revenue Code (Code) and the Employee Retirement Income Security Act (ERISA) by cross-reference. However, rather than establish specific unique standards for fully-insured plans, PHSA Section 2716 simply says that the non-discrimination rules that apply to fully-insured plans shall be “similar” with respect to eligibility, benefits, controlled group testing, and who is a highly compensated individual to the rules governing self-insured plans under Code Section 105(h).

BUCK COMMENT. *Despite Section 105(h) being in the Code since 1980 (and regulations being issued in 1981), many aspects of how the nondiscrimination rules apply to self-funded plan have remained unanswered. The introduction of account-based health plans, such as health reimbursement accounts, has raised additional uncertainty.*

PHSA Section 2716

The nondiscrimination rules of PHSA Section 2716 for fully-insured plans do not apply to “grandfathered,” fully-insured health plans (i.e., generally, plans whose design has not been changed). They also do not apply to self-

insured plans, which remain subject to the current nondiscrimination rules of Code Section 105(h). For example, medical diagnostic plans (such as executive physicals) were never treated as a health plan subject to the nondiscrimination rules of Code Section 105(h) and remain not subject to nondiscrimination rules, whether self-insured or fully-insured.

Under Code Section 105(h), discrimination in a self-insured plan results in the benefits of highly compensated individuals being taxed. Under PHSa Section 2716, failure to comply can result in an excise tax of \$100 for each day in the noncompliance period with respect to each individual to whom the failure relates (subject to a reasonable cause exception). In the case of an ERISA-covered plan, there is also the potential for a civil action compelling the employer to provide nondiscriminatory benefits. Civil money penalties under PHSa may apply for public plans.

Notice 2010-63

In September 2010, IRS issued [Notice 2010-63](#) requesting input on what guidance was needed with respect to PHSa Section 2716. Comments emphasized the need for the IRS to issue regulatory guidance as to the meaning of the nondiscrimination rules for fully-insured plans being “similar” to the nondiscrimination rules for self-insured plans under Code Section 105(h). Many of the comments also pointed out that there are many unanswered questions as to how the Code Section 105(h) nondiscrimination rules apply currently to self-insured plans.

***BUCK COMMENT.** Before the IRS can address the meaning of “similar,” it will have to address many of the unanswered questions about the Section 105(h) rules. Thus, this project could affect the many employers who self-insure plans as well as those who have not had to worry up until now about nondiscrimination because their plans were fully insured. Many of the current assumptions as to what plans satisfy, or would satisfy, the nondiscrimination rules may turn out to be wrong once the IRS issues guidance. Guidance is likely to make it impossible for an employer to provide executive-only plans, unless the plan was grandfathered.*

Notice 2011-1

[Notice 2011-1](#) provides that fully-insured plans do not have to comply with the nondiscrimination rules until IRS issues guidance under PHSa Section 2716. Accordingly, a sponsor of a fully-insured plan will not be subject to the excise tax penalty under Code Section 4980D and will not have to file IRS Form 8928 with respect to excise tax penalties for years before the IRS issues the regulations. (While only the IRS issued Notice 2011-1, the Notice states that the Departments of Labor and Health and Human Services agree with the delay.)

In providing the delay, the IRS highlights the lack of comprehensive regulatory guidance under Code Section 105(h) and the lack of any guidance as to the meaning of “similar” under PHSa Section 2716. In addition, the IRS

highlights the need to determine how to apply the nondiscrimination rules starting in 2014 when employees will be able to purchase health insurance under the state exchanges.

BUCK COMMENT. *The Notice emphasizes the need to determine how to take into consideration exchange-purchased coverage starting in 2014. It also mentions the lack of full nondiscrimination guidance for self-insured plans under Code Section 105(h), guidance to which the rules for fully-insured plans under PHSA Section 2716 are supposed to be similar. The Notice states that sponsors will be provided with sufficient implementation time after the guidance is issued. In light of this, it would be reasonable to expect that no guidance will be effective until 2014.*

Request for Comments

In addition to delaying the compliance date, the Notice asks for public comment on 13 specific questions and invites further comments on any other areas that need guidance. Included in the questions are some fundamental Section 105(h) questions such as whether participant contributions count in the determination of nondiscriminatory benefits, what highly compensated individual definition is permissible, how expatriates and inpatriates are to be treated in the test, the rules for multiple-employer plans, the treatment of after-tax contribution-only plans, and the transition rules for mergers, acquisitions, and other corporate transactions.

There are also questions going to how much flexibility IRS has to distinguish between the self-insured rules under Code Section 105(h) and the fully-insured rules under PHSA Section 2716 based on the statutory requirement that the rules be “similar.” The Notice raises questions such as do the agencies have authority to provide for fully-insured plans: eligibility-only testing, special nondiscrimination safe harbors, or a different definition of highly compensated individual? Can testing be done on a geographical basis? How should the rules deal with employees who waive coverage in favor of other coverage (such as exchange coverage or spousal coverage)? The Notice also asks about how the sanctions should be applied since the PHSA Section 2716 sanction of \$100 per day per participant is far more severe than the Code sanction for violation of Code Section 105(h) (taxation of the highly compensated employees on their benefits).

BUCK COMMENT. *Unless IRS rethinks its current interpretation of the penalties for discrimination in a fully-funded plan, or there is a legislative change, the consequence of discrimination in a fully-insured plan will be dramatically greater than in a self-insured plan.*

Conclusion

The addition of nondiscrimination rules for fully-insured plans changes the planning landscape. Most sponsors with plans just for their executives have chosen to grandfather those plans. Thus, for them, the delay will make little difference from a planning viewpoint because once the grandfather is lost, it is lost forever. For those who gave up the grandfather, the delay is welcome news. They no longer need to be immediately concerned that the

program they put in place in the absence of regulations might not satisfy nondiscrimination rules and subject them to an excise tax penalty. In the case of sponsors of self-insured plans, the passage of PHSA 2716 and the need to write “similar” rules for fully-insured plans virtually guarantees that the IRS will reexamine the existing rules for self-insured plans, with a likely consequence of some self-insured plans having to be redesigned once the guidance is published.

Buck’s consultants remain available to discuss how the Notice impacts your health plans and help you make design decisions or respond to the IRS request for public comment.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.