



Section 105(h) Nondiscrimination Rules For Fully-Insured Group Health Plans

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Extension of Nondiscrimination Rules

Under health care reform, non-grandfathered fully-insured group health plans will be required to comply, for the first time, with some of the same federal nondiscrimination rules related to benefits and eligibility that, up until now, have applied only to self-funded plans. This requirement is effective for plan years beginning on or after September 23, 2010. Although unclear to the exact application, the requirements of Internal Revenue Code Section 105(h)(2) prohibit discrimination in terms of eligibility and benefits in favor of highly compensated individuals.

Highly Compensated Individual (HCI)

A highly-compensated individual for purposes of these rules is an individual who is:

- One of the five highest paid officers;
- A shareholder who owns more than 10 percent in value of the stock of the employer; or
- One of the highest paid 25 percent of all employees (other than an employee excludable as described below).

Eligibility Test

To pass the eligibility test, a plan must benefit one of the following:

- At least 70 percent of all employees;
- At least 80 percent of all employees who are eligible to benefit under the plan (if at least 70 percent of all employees are eligible to participate in the plan); or
- A nondiscriminatory classification of employees (there must be a bona fide business reason for the classification and a sufficient ratio of non-HCIs must benefit)

In running the eligibility test, an employer may exclude certain employees from consideration. These are employees who:

- Have not completed three years of service;
- Have not attained age 25;
- Are part-time or seasonal;
- Are collectively-bargained; or
- Are non-resident aliens who do not receive U.S. earned income.

Benefits Test

To pass the benefits test, all benefits provided to the HCIs who participate in the plan must be provided to all other participants as well. A plan must not:

- discriminate on its face in providing benefits in favor of HCIs; OR
- discriminate in favor of HCIs in actual operation (whether a plan discriminates in operation is determined on a facts and circumstances basis).

Penalty

Penalty for non-compliance of fully-insured plans under Healthcare Reform is \$100 per day for each individual with respect to which the failure relates. Employers subject to the penalty are required to self-report and pay the excise tax using IRS Form 8928. It appears that small employers (less than 50 employees), though subject to the nondiscrimination rules, may not be subject to the penalty.

Conclusion

The rules, as previously applied only to self-funded plans, have consistently been considered vague and open to interpretation, especially in terms of employer contribution. The Department of the Treasury and the IRS has requested public comments on the extension and application of the rules to fully-insured plans in advance of clarifying guidance. To view IRS Notice 2010-63, please visit <http://www.irs.gov/pub/irs-drop/n-10-63.pdf>.

In the meantime and absent further clarification, a plan that treats all employees the same (providing same coverage options to all who are eligible, same waiting period, same employer contribution, etc.) generally needn't be concerned with the nondiscrimination issue. Treating employees differently in any way, whether in the plan document or in operation, raises red flags that should be checked with legal counsel or a tax advisor.

For additional information, please contact your Lawley Benefits Consultant.

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