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The Affordable Care Act's Nondiscrimination Rules: Advance Warning

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The March 2013 issue of *Oregon Healthcare News* informed readers about the employer mandate in the Affordable Care Act (ACA). The ACA also extended and added teeth to certain health-plan nondiscrimination rules. Unlike the employer mandate, the nondiscrimination rules may apply to small employers as well as large.

Existing Health Plan Nondiscrimination Rule

Self-insured health plans have been subject to the nondiscrimination rules in section 105(h) of the Internal Revenue Code since 1978. Those rules prohibit discrimination in favor of "highly compensated individuals" (HCIs) with respect to eligibility and benefits. To the extent such a plan is discriminatory, the favored HCIs may be subject to tax on their coverage or benefits.

What the ACA Did

The ACA extended to insured medical plans nondiscrimination rules "similar to" those applicable to self-insured plans. The new rules do not apply to "grandfathered" health plans, "limited-scope," separate dental or vision plans or self-insured health plans.

The new rules were scheduled to take effect for plan years beginning after September 22, 2010, but have been delayed pending guidance on how to apply the rules. The rules may take effect for plan years beginning in 2014, but the guidance still has not been issued, so that is uncertain.

In addition to extending the reach of the nondiscrimination rules, the ACA imposes drastic penalties if a plan is discriminatory under the new rules. The plan may be sued to provide nondiscriminatory benefits, and the plan sponsor may be subject to a penalty tax of $100 per day for "each individual to whom the failure relates." So, for a non-grandfathered, insured medical plan covering all 10 of the employer's HCIs and excluding all 30 of its non-HCIs, the penalty tax could accumulate at $3,000 per day (30 x $100), and any of the excluded participants, or the U.S. Department of Labor, could sue to enjoin the plan's discriminatory eligibility provision.

What Are the Nondiscrimination Rules?

The new rules are expected to prohibit discrimination with respect to both eligibility and benefits.

The eligibility tests (there are three alternative tests) measure whether the group of employees who actually

benefit under the plan on the same terms are a nondiscriminatory group of non-HCIs as well as HCIs. The tests are too technical to summarize here, but all of them (especially the "fair-cross-section" test borrowed from IRS regulations for tax-qualified retirement plans) offer significant flexibility.

While a medical plan that excludes all non-HCIs generally will fail the tests (unless, perhaps, all of those non-HCIs are covered by a *bona fide* collective bargaining agreement), a plan that excludes a significant percentage of the non-HCIs may well pass. For example, a plan that covers all five of an employer's HCIs and also covers 10 of the employer's 20 non-represented non-HCIs on the same terms may well pass.

The benefits test measures whether all benefits provided for HCIs are also provided for all other plan participants. It looks not only at the plan terms but also at the plan in operation.

What Plan Designs May Be Risky?

Although the absence of guidance makes it impossible to predict what plan designs will comply with the new rules, these are some designs that raise questions:

- Different plans for employers within a "controlled group" or "affiliated service group"
- Plans that exclude some of the non-union non-HCIs
- Unequal benefits (*e.g.*, 10% coinsurance for longer-service employees but 20% coinsurance for shorter-service employees)
- Non-uniform contributions (*e.g.*, employer pays for family coverage for HCIs but employee-only coverage for non-HCIs)
- Non-uniform waiting periods (*e.g.*, no wait for HCIs, 60-day wait for non-HCIs)
- Dual-choice options where non-HCIs disproportionately choose the lower-value option
- Plans with employee contributions that permit opt-out where non-HCIs disproportionately opt out
- Subsidizing COBRA coverage for highly compensated former employees.

What Are Employers' Options?

An employer with an insured medical plan should consult its advisors about whether the plan may be discriminatory. If the plan may be discriminatory, the employer might consider the following options:

- Retain grandfathered status, if still possible
- Self-insure the benefits, if that is financially appropriate
- Terminate the health plan (subject to the employer mandate, if applicable, discussed in the OHN article cited above)
- Review the penalties for non-grandfathered, insured, discriminatory medical plans
- Redesign the plan to eliminate discrimination.

Redesigning the plan may involve taking one or more of the following steps:

- Permitting additional non-HCIs to participate
- Providing uniform contributions and benefits for a nondiscriminatory class of HCIs and non-HCIs
- Facilitating pre-tax payment for coverage with a cafeteria plan
- Adjusting cash compensation to offset the contribution and benefit changes above.

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