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New Non-Discrimination Rules for Insured Health Care Plans May Result in Penalties for Employers

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The Patient Protection and Affordable Care Act includes new non-discrimination rules for insured health care plans maintained by businesses for their employees. Under these new rules, employers may not discriminate in favor of "highly compensated individuals" as to the eligibility to participate in an insured health care plan or as to the benefits provided under an insured health care plan.

The new rules do not apply to self-insured health care plans, which continue to be subject to the provisions of Section 105(h) of the Internal Revenue Code. However, the new rules do incorporate by reference several of the provisions found in Section 105(h) of the Internal Revenue Code, such as the exclusion of certain employees (i.e., part-time employees, employees who have completed less than three years of service) and the definition of a "highly compensated individual." The new rules, effective for plan years beginning on or after September 23, 2010, are found in new sections added to the Public Health Service Act (Section 2716), the Internal Revenue Code (Section 9815) and ERISA (Section 715). Recently, in Notice 2010-63, the Department of Treasury and the Internal Revenue Service (the "IRS") provided initial guidance regarding these new rules and indicated that further guidance may be forthcoming.

Under the new rules, employers are penalized for non-compliance. This is in contrast to Section 105(h) of the Internal Revenue Code, which taxes highly compensated individuals on their receipt of discriminatory benefits. Under the new rules, the penalty is an excise tax imposed on the employer under Section 4980D of the Internal Revenue Code. Specifically, an employer sponsoring a non-complying insured health care plan will be subject to an excise tax in the amount of $100 per adversely affected participant for each day of non-compliance (up to a maximum penalty for an unintentional failure of $500,000 for a taxable year). The IRS has discretion to waive the excise tax in whole or in part to the extent the failure was due to reasonable cause and not to willful neglect. The penalty does not apply to businesses employing 50 or

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fewer full-time equivalent employees, if eligibility for health insurance coverage is determined solely under the insurer's contract. An employer also may be subject to a similar penalty, based on each employee discriminated against, that is imposed by the Department of Health and Human Services. In addition, under ERISA, a non-compliant plan may be subject to a civil action to compel it to provide non-discriminatory benefits.

The new rules do not apply to "grandfathered health plans." These are group health care plans that were in existence as of March 23, 2010, and not materially modified on or after September 23, 2010.

The new rules may become applicable in any situation where an employer provides supplemental health care insurance (which, for example, would include long-term care insurance) for its executive employees or pays a greater portion of health care premiums (including COBRA premiums) for a former or current executive than it does for other employees. Therefore, employers should consider reviewing executive level employment agreements, offer letters, severance/separation agreements and any other documents that provide for supplemental, subsidized or extended health or long-term care insurance coverage for highly compensated employees in light of these new rules.

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