



Client Alert

November 15, 2010

New Nondiscrimination Requirements For Health Insurance

The Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively referred to as the "Health Care Act") impose significant penalties on employers who discriminate in providing health insurance benefits. Although these penalties were often overlooked in the healthcare reform debate, employers must take the appropriate steps to make sure that all group health insurance plans conform to the new requirements.

Historically, employer-provided health care coverage (other than self-insured plans) was not subject to nondiscrimination requirements. The Health Care Act now imposes nondiscrimination requirements for insured group coverage. The nondiscrimination requirements that applied to self-insured plans before enactment of the Health Care Act continue. Therefore, this Client Alert focuses on the new nondiscrimination requirements that relate to employer-provided group health insurance coverage only.

Nondiscrimination Requirements. The Health Care Act incorporates the substantive nondiscrimination requirements of Internal Revenue Code Section 105(h) (but not the taxes on highly compensated individuals in Section 105(h)(1)) and applies them to insured group health plans.

Generally, a plan discriminates in favor of highly compensated individuals unless (a) the plan benefits 70 percent or more of all employees, (b) at least 70 percent of all nonexcludable employees must be eligible to participate and at least 80 percent of all eligible employees must participate, or (c) the IRS finds the classification of employees to be nondiscriminatory. A "highly compensated individual" is an individual who is (i) one of the five highest paid officers, (ii) a shareholder who owns more than 10 percent in value of the stock of the employer, or (iii) among the highest paid 25 percent of all employees. Certain employees are not included in determining who is a highly compensated individual (e.g. part-time, seasonal and collectively bargained for employees).

Penalties. The Health Care Act provides for a penalty of \$100 per day per participant on employers who sponsor an insured group health plan that does not satisfy the nondiscrimination requirements. The penalties for unintentional failures are maxed out at \$500,000 per tax year. Note this penalty does not apply to self-funded plans. For self-funded plans, highly compensated individuals are subject to tax.

Exempt Plans. Health plans in effect before the enactment of the Health Care Act (i.e. March 23, 2010) are grandfathered. See our June 23, 2010 Client Alert: "Proposed Regulations on Grandfather Plans under New Health Care Law Issued" for a discussion of how a plan maintains its grandfathered status.

Effective Date. These nondiscrimination rules apply to group health plans that are not grandfathered effective the first plan year beginning after September 23, 2010.

Unless an employer's group health plan is grandfathered or is exempt, the sponsor should take immediate action to evaluate whether its insured plan satisfies new nondiscrimination requirements.

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