

Nondiscrimination Testing for Insured Health Plans



GRANT ROLLINS, DATAPATH, INC.

What We'll Cover

2

- Which plans must test?
- What are the tests?
- What are the consequences of a test failure?

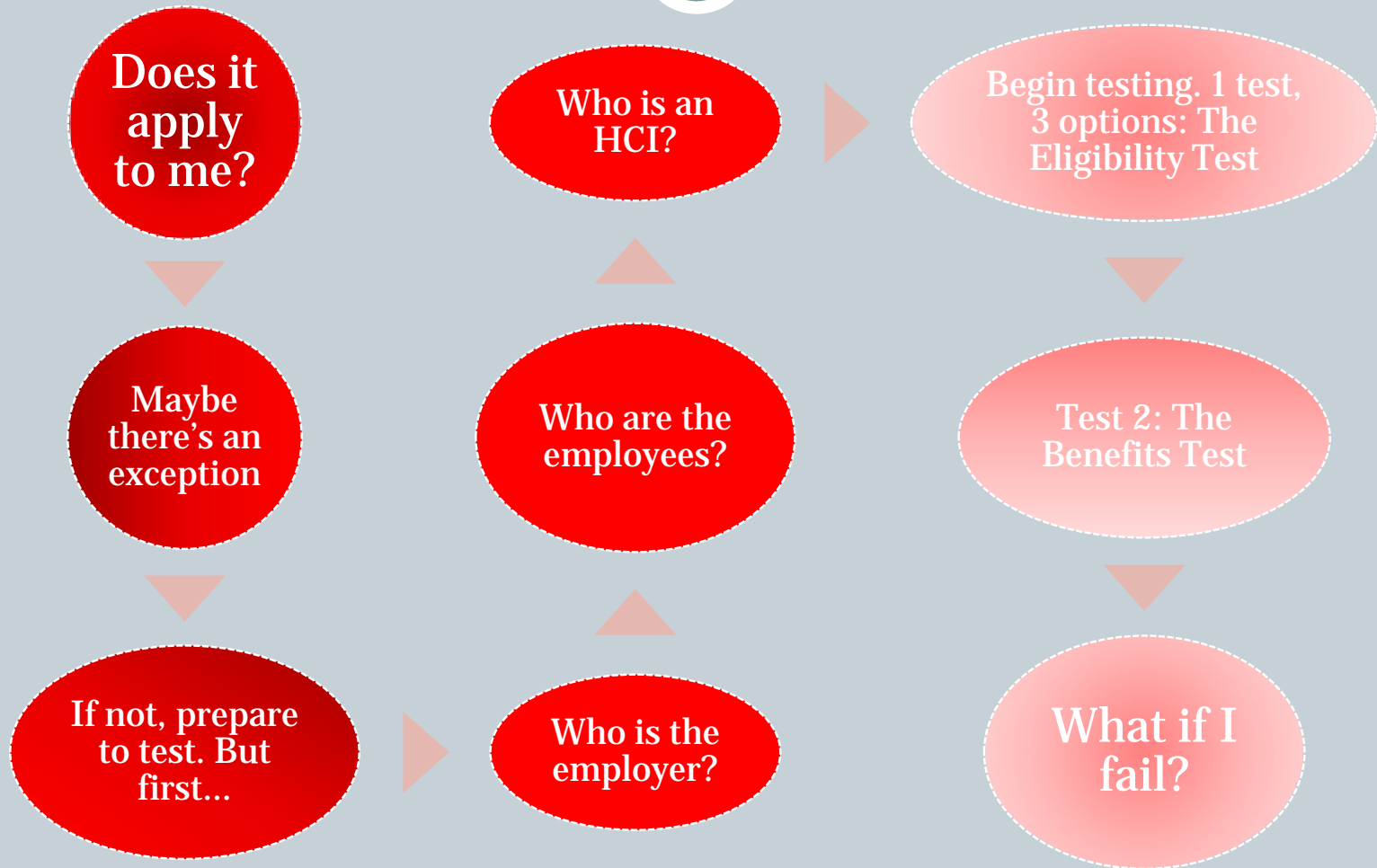
Big Picture

3

- **Why me, Lord?**
 - The nondiscrimination rules were first developed for self-insured plans because these plans enjoyed favorable tax treatment.
 - The tax break was afforded in effort to encourage employers to provide benefits to their morally superior rank-and-file employees
 - Congress wanted to ensure that rank-and-file got their fair share of tax benefits
 - “Fair” is undefined

Dante's New and Improved 9 Levels

4



Who must comply?

5

- Insured plans established after March 23, 2010
- Insured plans who lose their grandfathered status
- “Health plan” - An employee welfare benefit plan to the extent that the plan provides medical care to employees or their dependents directly or through insurance, reimbursement, or otherwise. (PHSA, ERISA)

Who escapes compliance?

6

- **Grandfathered plans**
- **Excepted benefits:**
 - Certain benefit types (e.g. accident-only, disability income)
 - Limited scope (e.g. vision, dental)
 - GHP w/ < 2 employees
 - HSAs, MSAs, and Health FSAs (if conditions met)
 - Retiree-only
 - Several others
- **Certain small employers (maybe):**
 - no tax shall be imposed by [4980D] on the employer on any failure (other than a failure attributable to section 9811) which is solely because of the health insurance coverage offered by such issuer.
 - “Employer” – those who employed an average of at least 2 but no more than 50 during the preceding calendar year.

Requirements of Code § 105(h)(2)

7

- **Eligibility Test (3 options)**
 - 70% test (easiest to perform, hardest to pass)
 - 80%/70% test
 - Nondiscriminatory classification (hardest to perform, easiest to pass)
- **Benefits Test**
 - Nondiscriminatory on the face of the plan
 - Nondiscriminatory in operation
- **Note that PHSA § 2716 provides for the application of “rules similar to” those in Code § 105(h) regarding the Eligibility and Benefits Tests, controlled groups, and affiliated service groups, thus raising the possibility that the Code § 105(h) rules may not apply in their entirety to insured plans.**

What you must know before testing

8

- **Who is the employer?**
 - What kind of entity are you? (Corp., group under common control, or affiliated service group)
- **Who are the employees?**
 - Who are the leased employees? Shared employees?
Independent contractors?
- **Who is an HCI?**

Who is the employer?

9

- This answer should be fairly painless for most employers
- More pain for multiple employers with common ownership
 - If aggregated for testing, the entity is known as a “controlled group of corporations”
 - ✦ Constructive ownership rules apply
 - Rules for knowing when to combine are similar for corporations and “trades or business under common control” (e.g. partnerships)
 - Special rules for affiliated service groups

Controlled Group of Corporations

10

- **3 types of groupings**
 - Parent-subsidiary (80%/80%)
 - Brother-sister (<6 - 80%/50%)
 - Combined group
- **When determining ownership, “constructive ownership” rules apply**
- **Example: Alice is a 50% shareholder of Shore Corporation. Shore owns 50% of Beach Corporation. Under the constructive ownership rules, Alice is deemed to own 25% of Beach because 50% of the Beach stock that is owned by Shore is attributed to Alice.**

Affiliated Service Group

11

- “Service organization” – e.g. law firm, medical practice
- 3 combinations:
 - First service organization (FSO) and A-organization (A-Org)
 - FSO and B-Org
 - Group performing management service

Who are the employees?

12

- **Leased employees are counted, so who is a leased employee (LE)?**
 - LE's services provided pursuant to an agreement;
 - LE has performed such services on substantially full-time basis for at least a year; and
 - LE's services are performed under primary direction or control of the recipient
- **Rules do not require that you actually provide coverage for LEs if you can pass the tests doing so**

Who are the HCIs?

13

- One of the five highest-paid officers;
- A shareholder who owns > 10% of the value of stock of the employer's stock; or
- One of the highest-paid 25% of all employees (unless excluded)

The 5 ~~Over~~ Highest-Paid Officers

14

- “Officer” not defined but determined on the basis of all facts and circumstances (need more than title)
- What time period for determining compensation level?
 - The level of an employee’s compensation is determined on the basis of the employee’s compensation for the plan year.
 - Fiscal year plans may determine employee compensation on the basis of the calendar year ending within the plan year
 - No look-back rule (although some use it anyhow)

Highest-Paid 25% of Non-Excludable Employees

15

- **“Compensation” not defined but may use a reasonable definition (Code § 415(c)(3))**
 - The number of employees is rounded up to the next highest number (e.g. in a 5-employee company, the top 2 count)
- **The level of an employee’s compensation is determined on the basis of the employee’s compensation for the plan year**
- **Who can be excluded?**
 - < 3 years service
 - < age 25
 - part-time/seasonal
 - Collectively bargained
 - Non-resident aliens who receive no U.S. source earned income

Congratulations...You're Ready to Begin

16

- **What we've covered**
 - Nondiscrimination applies to us because we're an insured health plan
 - No exceptions apply to us
 - We've determined who the employer is
 - We've determined which employees need to be counted
 - We've determined who the Highly Over-compensated Individuals are
- **Let's test!**

Or, Not...Preliminary Considerations

17

- **Expanding benefits in order to pass**
 - Perhaps questionable, but one can provide de minimis benefits so that everyone enrolled is considered to “benefit”
 - Participation in an ancillary benefit may be too low to pass the Eligibility Test. You can make it part of you major medical plan. (Tres. Reg. § 1.105-11(c)(4))
- **What does it mean to “benefit”?**
 - Girly approach: in order to benefit, an employee must have elected coverage or have been provided with free coverage by plan design
 - Manly approach: in order to benefit, an employee only need to be eligible to elect coverage

Test 1: The Eligibility Test

18

- **70% test**
 - The plan must benefit 70 percent or more of all employees
- **70%/80% test**
 - 70 percent need to be eligible to participate, and 80 percent of that 70 percent must actually participate
- **Nondiscriminatory classification**
 - Employees qualify under an employer or IRS-approved classification
 - ✦ Post-TRA test (Classification is 1. reasonable and 2. nondiscriminatory; Safe Harbor Percentage Test)
 - ✦ Pre-TRA test (You don't want to know)

Test 2: The Benefits Test

19

- **Part 1: no discriminatory benefits on the face of the plan**
 - Required employee contributions must be identical for each benefit level
 - The maximum benefit level cannot vary based on age, years of service, or compensation
 - The same type of benefits that are available to HCIs must be available to Non-HCIs
 - Disparate waiting periods cannot be imposed
- **Part 2: no discriminatory benefits in operation**
 - Facts and circumstance determination

Administering the Tests

20

- Conduct test before, during, and after the plan year
- Gather necessary data to conduct testing (employee count, compensation data, etc.)
- Determine whether plan design changes are needed

What Happens if the Plan is Discriminatory?

21

- Because the nondiscrimination requirement appears in PHSA § 2716 and not in Code § 105(h), it would appear that failure to comply will **not** result in adverse tax consequences to HCIs.
- Penalty - the excise tax under Code § 4980D
 - \$100/day for each day in the noncompliance period for each individual to whom the failure relates (this period ends when the failure is corrected; “individual” is not specified)
- How to correct compliance failures?
 - A failure of a group health plan shall be treated as corrected if— (A) such failure is *retroactively undone* to the extent possible, and (B) the person to whom the failure relates is placed in a financial position which is *as good as* such person would have been in had such failure not occurred.

Nondiscrimination Testing Safe Harbors

22

- **Simple cafeteria plans**
 - Treated as meeting the nondiscrimination rules
 - Available to eligible small employers – averaged 100 or fewer employees during either of the two preceding years.
 - ✦ Can exclude certain employees
 - ✦ Special rules for new and growing employers
 - Employer must contribute a uniform percentage (not < 2%) of the employee's compensation
 - ✦ Or, contribute an amount that exceeds or equals the lesser of 1) 6% of employee's compensation for the plan year or 2) twice the employee's salary reduction