**HEALTH CARE REFORM AND NONDISCRIMINATION RULES**

**What are the health insurance income tax nondiscrimination rules?**

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| Prior to the Affordable Care Act (ACA), the Internal Revenue Code only imposed nondiscrimination rules on self-insured health plans. No benefits-related nondiscrimination rules applied to an insured health plan. Thus, an insured group health plan could cover management and other highly paid employees under terms that were more favorable than those applicable to other employees, or not even insure them at all. Self-insured plans and employers’ medical expense reimbursement plans are subject to the nondiscrimination provisions of Code Section 105(h), in effect since 1980. Congress originally believed that insurance underwriting considerations limited abuses favoring the highly paid in insured plans. However, underwriting practices in fact allowed plans to favor the highly compensated. Health reform imposes similar rules to those that apply to self-insured plans or insured group health plans, other than grandfathered plans. The law does this in a very circular way. The ACA incorporated new ERISA Section 715 and Code Section 9815, respectively. Both ERISA Section 715 and Code Section 9815 incorporate by reference Public Health Service Act (PHSA) Section 2716, which incorporates by reference the concepts of Code Section 105(h). The law leaves the details of the insured plan nondiscrimination rules to the regulations. It merely requires “rules similar to” those in Code Section 105(h), regarding nondiscrimination eligibility, nondiscriminatory benefits, and controlled groups. These rules prohibit discrimination in favor of highly compensated individuals (HCIs), who are generally the highest paid 25 percent of the employer’s workforce. |

**What is the consequence of violating the health insurance nondiscrimination rules?**

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| As a result of incorporating the HIPAA penalty, the excise tax that applies in the event of a violation of the HIPAA requirements also applies in the event of a violation of these new nondiscrimination requirements. The health insurance nondiscrimination rules for nongrandfathered plans have different and potentially much harsher sanctions than for self-insured plans that fall under Code Section 105(h). For discriminatory self-insured plans, the highly compensated employees have taxable income based on the benefits paid by the employer. However, with respect to the new health insurance nondiscrimination requirements, the sanction is a $100 per day excise tax on the “affected employees” and is paid by the employer or the plan in the case of a multiemployer plan. While the IRS has not yet issued any regulations on the penalty, its request for comments indicates that the term “affected employees” means all those who are not highly compensated. Thus, if an employer has an insured health plan that is not grandfathered and violates these new nondiscrimination rules for the plan year beginning on or after September 23, 2010, and if that employer has twenty non-highly compensated employees, the penalty will be $2,000 per day (20 employees X $100/day) as a result of having a discriminatory non-grandfathered health insurance plan. |

**What is the small employer exception to the application of the excise tax, and does it apply to avoid the nondiscrimination tax penalty?**

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| Code Section 4980(D)(d)(1) contains an exception to the excise tax for small employers, but the language is somewhat ambiguous. It states: In the case of a group health plan of a small employer which provides health insurance coverage solely through a contract with a health insurance issuer, no tax shall be imposed by this section on the employer on any failure *which is solely because of the health insurance coverage offered by such issuer.* (Emphasis added.) It is not clear whether this exception applies to the new nondiscrimination rules or simply to a health insurance policy that does not meet federal requirements. The italicized language may mean that the exception will apply only if the insurance policy is discriminatory as opposed to the employer’s plan being discriminatory. In other words, the small business exception may not apply if the plan, rather than the insurance policy, is nondiscriminatory. For the purpose of this exception, a small employer is defined as one with two to fifty employees. |

**What are the issues involved in applying the nondiscrimination excise tax?**

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| Code Section 4980D(a) imposes an excise tax on the failure of a group health plan to meet the requirements of Chapter 100 relating to group health plans. The amount of tax is $100 for each day in the noncompliance period with respect to each individual to whom such failure relates. Notice 2011-1 deferred the effective date of the insured plan nondiscrimination rules and indicates that the penalty will apply to nonhighly compensated individuals (“NHCIs”). Notice 2011-1 states: [I]f an insured group health plan fails to comply with Code Sec. 105(h), it is subject to a civil action to compel it to provide nondiscriminatory benefits and the plan or plan sponsor is subject to an excise tax or civil money penalty of $100 per day ***per individual discriminated against***. [Emphasis added.]The noncompliance period is the period beginning on the date on which the failure occurs,and ends on the date the failure is corrected. A failure is treated as corrected if it is retroactively undone to the extent possible,and the person to whom the failure relates is placed in a financial position that is as good as the position such person would have been in had the failure not occurred. |

**What are the limits or exceptions to the application of the nondiscrimination excise tax on nongrandfathered insured plans?**

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| There are a number of limitations on the amount of the tax. First, no tax is imposed on any failure during any period for which it is established to the satisfaction of the IRS that the person liable for the tax did not know, and, exercising reasonable diligence, would not have known that such failure existed.For church plans, no tax is imposed if the failure is corrected before the end of the correction period. For most plans, no tax is imposed if the failure was due to reasonable cause and not to willful neglect,and such failure is corrected during the thirty-day period beginning on the first date the person otherwise liable for such loss knew, or exercising reasonable diligence would have known, that such failure existed. Notwithstanding these limits on the excise tax, in the case of one or more failures for an individual before the date a notice of examination of income tax liability is sent to the employer, and when such failure occurred or continued during the period under examination, there is a minimum tax with respect to such individual of not less than the lesser of $2,500, or the amount of tax that would have been imposed without regard to the limitations on tax.To the extent that the violations are more than *de minimis* (an undefined term), $15,000 is substituted for $2,500.With respect to unintentional failures (i.e., those due to reasonable cause and not to willful neglect), the tax imposed on single employers for failures during the employer’s tax year cannot exceed the lesser of: ·10 percent of the aggregate amount paid or incurred by the employer (or predecessor employer) during the preceding tax year for group health plans, or ·$500,000.With respect to specified multiple employer health plans,the excise tax cannot exceed the lesser of ·10 percent of the amount paid or incurred by such trust during the tax year to provide medical care directly or through insurance, reimbursement, or otherwise, or ·$500,000.However, if an employer is assessed a tax by reason of failure with respect to a specified multiple employer health plan, the limit is determined in the same manner as for a single employer plan, rather than for a specified multiple employer health plan. For a failure due to reasonable cause and not to willful neglect, the IRS may waive all or a portion of the tax to the extent that the payment of such tax would be excessive relative to the failure involved.The excise tax does not apply to a group health plan of a small employer providing coverage solely through a contract with a health insurance issuer with respect to a failure due to the health insurance coverage offered by the issuer.  |

**Who is liable to pay the excise tax?**

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| Liability for the tax is generally imposed on the employer.However, the tax will be imposed on the plan with respect to a multiemployer plan or a failure under Code Section 9803 relating to guaranteed renewability with respect to a multiple employer welfare arrangement. |

**How is the liability for the excise tax reported?**

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| Employers subject to the excise tax must file Form 8928. For single employer plans, the employer must file the return on or before the due date for filing the employer’s income tax return unless a separate extension request is filed properly for Form 8928. It also must reflect the portion of the noncompliance period for each failure that occurs during the employer’s tax year. If the “person” liable for the excise tax is a specified multiple employer health plan, the return must be filed on or before the last day of the seventh month following the end of the plan’s plan year. |

**What if the failure to meet the nondiscrimination rules is due to reasonable cause and not willful neglect?**

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| As to whether the failure was due to reasonable cause and not to willful neglect, the issue will likely not be whether the plan sponsor had some reasonable basis for a position but rather will be a matter of inadvertence. For example, whether a participant failed to receive an SPD or open enrollment material, or whether some documents relating to verification, or clarification of grandfathered health plan status were not maintained usually arises in the context of an inadvertent error. In such a case, it may not be clear that, by exercising reasonable diligence, the employer would have known if the failure occurred.  A failure to give a notice or to maintain records is not as serious as a HIPAA violation, such as discrimination due to health status, which was the type of action that initially resulted in the imposition of this excise tax enacted with HIPAA. At a minimum, the amount of excise tax for the violation of the group health plan rules applicable only to non-grandfathered group health plans that do not violate HIPAA should depend on whether the plan administrator believed in good faith, albeit erroneously, that the plan had grandfathered status. |