Discrimination Testing Now Applies to Health and Dental Plans (another result of ACA)

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Prior to the passage of the Affordable Care Act (ACA), fully insured group health plans (i.e., plans that provide benefits strictly through insurance) were not subject to nondiscrimination requirements and could discriminate as to eligibility, contributions, benefits, etc., without triggering adverse tax consequences to the participants or the employer. Under a provision in the ACA, fully insured group health plans that are not grandfathered or that do not meet an exception for small employer plans will have to comply with certain federal nondiscrimination rules. The IRS, Department of Labor (DOL), and Department of Health and Human Services (HHS) have delayed compliance with the IRC Sec. 105(h)(2) nondiscrimination requirements for non-grandfathered fully insured plans until final regulations or other administrative guidance is issued. The agencies anticipate that these rules will not apply until plan years beginning after the guidance is issued. However, any fully insured group health plan offered by your business should be carefully analyzed to determine if the plan may be affected by the nondiscrimination rules.

In general, a plan must be nondiscriminatory with regard to both eligibility to participate in the plan and the benefits provided under the plan. A fully insured plan that is found to be discriminatory faces severe penalties. The plan may be subject to a civil action to compel it to provide nondiscriminatory benefits. Additionally, the plan or plan sponsor could be subject to an excise tax of $100-per-day for each individual who was discriminated against (i.e., for all participants who do not meet the definition of a highly compensated individual).

The following is a three step systematic approach to testing a plan for nondiscrimination:

1. Identify Highly Compensated Individuals (HCIs).
   In general, a HCI is:
   a. one of the five highest paid officers,
   b. a 10%-or-more shareholder, or
   c. one of the 25% of highest paid employees.

2. Perform the Eligibility Test.
   a. A plan does not discriminate as to eligibility if it covers any of the following:
      i. at least 70% of all employees
      ii. at least 80% of eligible employees, but only if at least 70% of all employees are eligible to benefit under the plan; or
      iii. a class of employees set up by the employer that the IRS has found to be nondiscriminatory based on facts and circumstances.
   b. Certain employees may be excluded from the eligibility discrimination testing, including:
      i. those who have not completed three years of service before the beginning of the plan year,
      ii. employees who are under age 25 at the beginning of the plan year,
      iii. certain part-time or seasonal employees,
      iv. employees covered by a collective bargaining agreement if certain conditions are met, and,
      v. employees who are nonresident aliens and receive no earned income from the employer from U.S. sources.

3. Perform the Benefits Test.
   For a plan to be nondiscriminatory with regard to benefits provided, it must provide the same benefits to highly compensated individuals (and their families) that are provided to all other participants. A plan can limit the maximum amount paid to a participant for any single benefit or combination of benefits (subject, of course, to other ACA provisions). However, any limit attributable to company contributions must be uniform for all participants and their families, and cannot be modified because of a participant’s age or years of service. Additionally, the type of benefits offered and the amount of benefits cannot be determined based on an employee’s compensation.

It is important that the plan meet these nondiscrimination requirements both in the plan design and actual plan operation. A plan is not considered discriminatory because a highly compensated individual uses the plan benefits more than other participants. However, a plan is discriminatory if the plan or a plan benefit is

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terminated, and the duration of the plan or benefit effectively discriminated in favor of highly compensated individuals. For example, if a plan covered orthodontic services only during the two-year period that the CEO’s son had braces, and then terminated that benefit, it would be discriminatory.

Careful consideration should also be taken by employers who provide post-employment health benefits to executives. It appears that providing special health insurance coverage, whether on a pre-tax or after-tax basis, may violate the nondiscrimination requirements. However, the employer may be able to design a post-employment package that will be considered a stand-alone retiree benefit, or provide additional after-tax income to the executive that he or she can use (but is not required to use) to purchase health insurance coverage in the individual market. Hopefully, additional guidance on post-employment benefits will be issued soon from the IRS.

As previously mentioned, these new rules do not apply to grandfathered fully insured plans that maintain their grandfathered status. Additional information on how to maintain your plan’s grandfathered status can be found here Grandfathered Status,

Should you have any questions related to this topic, please contact your Keiter professional or our office. 804.747.0000 | information@keitercpa.com