IRS DELAYS APPLICATION OF NONDISCRIMINATION RULES FOR INSURED HEALTH PLANS

On On December 22, 2010, the Internal Revenue Service announced (in Notice 2011-1) that insured group health plans will not be required to comply with the nondiscrimination requirements under health care reform until some time after the IRS issues regulatory guidance on those requirements.

The Affordable Care Act provides that insured group health plans (other than certain "grandfathered" plans) must satisfy the requirements of Code Section 105(h)(2), which prohibits discrimination in favor of "highly compensated" participants in terms of either (i) eligibility to participate, or (ii) the benefits provided under the plan. The Act specifically provides that the terms "employer" and "highly compensated individual" (or "HCI") have the meanings given under Section 105(h). Prior to the Affordable Care Act, the nondiscrimination requirements of Section 105(h) applied solely to self-insured (i.e., self-funded) plans.

However, the consequences of violating the nondiscrimination requirements are quite different for insured plans. Code Section 105(h) currently provides that, if a self-insured plan discriminates in favor of one or more HCIs, those individuals will be taxed on some or all of the benefits that they receive under the plan (i.e., those individuals will "lose" the benefit of non-taxable health care reimbursements).

By contrast, if an *insured* plan violates the nondiscrimination rule, there are no tax consequences to the affected HCIs. Instead, the employer/plan sponsor is subject to an excise tax equal to $100 per day per non-highly compensated individual who is discriminated *against*. The employer may also be subject to a lawsuit by one or more federal agencies (or by the non-highly compensated individuals discriminated against) for the benefits that the non-highly compensated individuals did not receive.

Under the health care reform statute, these new requirements are to apply to non-grandfathered insured plans for plan years beginning on or after September 23, 2010. Thus, absent relief, these new rules would have applied to calendar-year insured plans beginning on January 1, 2011 (and they already apply to certain fiscal-year plans). However, Notice 2011-1 provides that insured plans will not be subject to the new rules - and will not be subject to the $100 per day per affected non-HCI penalty for violation of the rules - until plan years that begin after the IRS issues guidance on the application of these rules.

The IRS has also requested additional comments on how the Section 105(h) "eligibility" and "benefits" tests should be applied to insured plans. This additional comment period closes on March 11, 2011.

If you have any questions about how the new health care reform requirements apply to your group health plan, please contact your local UBA Mamber Firm.

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