



CLOSE-UP: Non-Discrimination Rules and Executive Medical Insurance

October 18, 2010

Prior to health care reform, federal tax rules discouraged self-insured plans from providing benefits to “highly-compensated employees” (as defined below) on a more favorable basis than other employees. These so-called “non-discrimination rules” did not apply to fully-insured group plans known as “executive medical plans.”

Under the Patient Protection and Affordable Care Act (PPACA), the non-discrimination rules of Section 105(h) of the Internal Revenue Code will now apply to fully-insured executive medical plans that are not “grandfathered” from many PPACA mandates (plans not in existence when PPACA was enacted on March 23, 2010) in plan years beginning on and after September 23, 2010. Under the new PPACA rule, an employer will be subject to substantial excise taxes if its non-grandfathered plan does not provide the same benefits for all plan participants – regardless of their position or compensation level. Plans in which individuals were already enrolled on March 23, 2010 are exempt from this provision as long as they remain grandfathered.

How is discrimination defined?

There are two forms of discrimination:

- Discrimination based on eligibility, such as longer waiting periods for lower level/lesser compensated employees or no coverage at all for lower level/lesser compensated employees

- Discrimination based on benefits, such as better copayments and deductibles for management than lower level/lesser compensated employees

The regulations provide an exception from the nondiscrimination requirements for “medical diagnostic procedures.” For example, an employer with a self-insured plan may provide executives with an annual physical exam without it being considered discriminatory.

What is the definition of a highly compensated employee?

For purposes of this requirement, highly compensated individuals generally include:

- The five highest paid officers
- A shareholder who owns more than 10 percent in value of the employer's stock
- An individual who is among the 25 percent highest paid of all employees

How do you determine whether an executive medical plan is discriminatory?

Insured and self-insured executive medical plans must submit to complex coverage and participation tests in order to determine whether they would satisfy the requirements of Section 105(h) of the Internal Revenue Code. Employers who are considering insured executive medical plans, or who may be required to enter into new insurance contracts for

executive medical plans, should first discuss discrimination testing with their tax advisor or benefits counsel.

How will the non-discrimination provision of PPACA be enforced?

Highly compensated employees will not be subject to income taxation on excess reimbursements if the fully-insured plan fails to satisfy the Section 105(h) testing requirements, as is the case for discriminatory self-insured plans. Instead, the employer will be subject to penalties if the fully-insured executive medical plan fails to comply with the non-discrimination rules. The amount of the excise tax is \$100 per day for each affected employee with a cap of \$500,000 per year.

Are all employers subject to excise taxes?

The Internal Revenue Code provides an exemption from the penalty for non-compliance for small employers that provide health coverage solely through a contract with a health insurance issuer. The term "small employer" means an employer who employed an average of at least two, but not more than 50, employees on business days during the preceding calendar year and who employs at least two employees on the first day of the plan year. Thus, although small employers are covered by the prohibition on discrimination in favor of highly compensated employees, there is currently no penalty for noncompliance. This may be a technical error that will be corrected in the future.

Important Note on....

Elimination of Lifetime Maximums

Although it was speculated that the Departments of Health and Human Services (HHS), Labor and Treasury might issue guidance permitting plans to apply limits to benefits received out-of-network, no such exception was included in the Interim Final Rule, or any guidance issued since.

In the absence of a specific exception by the agencies, Highmark's position is that placing such limits on out-of-network benefits is not permissible.

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Please note that information contained in this Close-Up is based on our understanding of the Patient Protection and Affordable Care Act of 2010, as amended, and guidance as of the date of this publication.