Healthcare Reform Non-Discrimination Rules & Testing

Starting with health plan renewals occurring after September 23, 2010 moving forward, all employers offering health care benefits are subject to non-discrimination rules and testing requirements, unless their plan is grandfathered in accordance with the Patient Protection and Affordable Care Act. In many instances, grandfathering is not an option for organizations with less than 50 employees, as many insurance companies are not offering this option. Many larger organizations are finding the grandfathering requirements too restrictive to maintain this status in the long run.

The non-discrimination requirements previously designed for self-insured plans now apply to fully insured plans, making it illegal to favor highly compensated employees. Organizations who offer different health plan options or benefits to different classes of employees either need to meet grandfathering provisions or make necessary changes to ensure compliance. This article will help you understand the non-discrimination rules and testing requirements.

Discrimination Tests

Although we are expecting more clarification on the specific requirements, it is the responsibility of employers to monitor non-discrimination compliance throughout the plan year. Organizations can conduct non-discrimination tests before the start of the plan year, or at any time during the plan year, to ensure compliance. However, continually making sure plans are compliant early can eliminate headaches later on.

When employees make their elections, the overall employee census and employee elections can be reviewed to ensure the benefits and key employee concentration requirements are actually met. Failures can be corrected early to avoid making any benefits taxable.

The nondiscriminatory testing requirements do not apply to individual plans or insured grandfathered group plans.

Self-insured group plans are subject to the non-discrimination rules as they existed before health care reform, regardless of whether they are grandfathered.

The plan must satisfy non-discrimination tests, an eligibility test, a benefit test, and a key employee concentration test. If a plan fails any of these tests, the favorable tax treatment for highly compensated individuals is lost and penalties may apply. Under Section 105(h) of the tax code the two tests a plan is required to meet are:

1) Eligibility Test

The plan cannot discriminate in favor of highly compensated individuals as to eligibility to participate. The plan must benefit 70% or more of all employees or 80% or more of all eligible employees if at least 70% of all employees are eligible to benefit under the plan. Generally, a plan must make sure all benefits available to HCEs are available to all other employees.

There are 3 alternative ways to pass the eligibility test:

1. 70 Percent Test:
   The plan benefits 70 percent or more of all non-excludable employees.

2. 70/80 Percent Test:
   The plan benefits 80 percent or more of all non-excludable employees who are eligible to benefit, if 70 percent or more of all non-excludable employees are eligible to benefit under the plan. First, determine whether 70 percent of employees are eligible under the plan. Then determine whether at least 80 percent of those eligible employees actually participate in the plan.

3. Non-discriminatory Classification Test:
   The plan benefits a non-discriminatory classification of employees. This requires a bona fide business classification for any exclusion and a sufficient ratio of benefiting non-highly compensated individuals to benefiting highly compensated individuals.

A plan may pass the eligibility test by excluding permitted categories of excludable employees. In running the eligibility tests, an employer may exclude the following employees:

- Employees who have not completed three years of service,
II) Benefits Test
The plan cannot discriminate in favor of HCEs with regard to the availability and use of benefits, meaning that participants must be given equal opportunity to select benefits, contributions must be made in a nondiscriminatory manner, and benefits must be utilized proportionately. Therefore, the plan cannot discriminate in actual operation, in addition to not discriminating in its design. The benefits test has two components: testing for discrimination on the face of the plan and testing for discrimination in operation.

The plan must include the following design features, in order to be non-discriminatory:
1. The required employee contributions must be identical for each benefit level.
2. The plan may establish a maximum reimbursement limit for any single benefit or combination of benefits. The maximum benefit level that can be elected cannot vary based on percent of compensation, age, or years of service.
3. All the benefits provided for participants who are highly compensated individuals must also be available for all other participants.
4. The plan cannot impose disparate waiting periods.

A plan must also not discriminate in favor of highly compensated individuals in actual operation. For example, discrimination in operation could arise if a plan administrator approves certain claims for medical expenses for highly compensated individuals while denying them for non-highly compensated individuals.

Highly Compensated Employees (HCE)
Employees are considered highly compensated if they fall into one or more of the following:
- One of the five highest paid officers;
- A shareholder owning (actually or constructively) more than 10% of the company’s stock;
- Among the highest paid 25% of all employees

These requirements are not mutually exclusive. The five highest paid officers may also be among the highest paid 25% of all employees. However, if one of the top five officers is not in that pay range, that officer still needs to be included in the highly compensated individual category.

An officer of the company is any officer who makes decisions on behalf of the entire company that would affect the profitability of the entire company.

Failing Non-Discrimination Tests
If a plan fails any of the non-discrimination tests, highly compensated employees or key employees may be taxed on the benefits received. Plans may also be subject to a $100 per day excise tax, per person, for each instance of failure. The Plan must also be modified to become compliant in order to be a valid plan.

This article is provided for your information and is subject to further clarification and correction as more information is available. Many provisions may be subject to change and/or further guidance from regulators. This summary is not intended as legal advice and you should consult with your own tax and benefit plan advisors regarding your particular situation.

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References:
- IRS Internal Revenue Service, Title 26, § 105
- Health Care Reform: Non-Discrimination Rules, KTB
- Health Care Reform Non-Discrimination Testing Requirements, HealthPartners.
- Non-Discrimination Testing for Group Health Plans FAQs, HMSA

Non-Discrimination Testing Assistance
For assistance testing health plans for non-discrimination contact HR Service, Inc. at: (801) 685-8400 or Ken@hrsereviceinc.com. Visit us online at: www.HRServiceInc.com.

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