

November 13, 2014

Ms. Carolyn Crowder
Executive Director
Tennessee Education Association
801 Second Avenue North
Nashville, Tennessee 37201-1099

Re: Application of Internal Revenue Code Section 105(h) to Discriminatory Self-Insured Health Plans

Dear Ms. Crowder:

We understand that certain insurance brokers have been making certain representations to school systems and other employers regarding the ramifications of a determination that a self-insured health plan violates the non-discrimination provisions of Section 105(h) of the Internal Revenue Code of 1986 ("Code"). In particular, we understand that such brokers have represented that (1) an employer whose self-insured health plan is determined to violate Code Section 105(h) could incur additional taxes or other liability under Code Section 105(h), and/or (2) an employer whose self-insured health plan is found to violate Code Section 105(h) could be fined up to \$100 per day for the failure to satisfy Section 2716 of the Affordable Care Act ("ACA").

Subject to the explanation below, it is our opinion that both such representations are clearly incorrect and inaccurate statements of current law.

Ramifications of a Plan That Violates Code Section 105(h): A self-insured health plan may not discriminate as to eligibility and benefits in favor of highly compensated individuals ("HCIs") (which includes the top-paid 25% of employees). If a self-insured health plan is discriminatory in favor of HCIs as to eligibility or benefits, then HCIs will be taxed on the "excess reimbursements" that otherwise would have been excluded from the gross income of such HCIs under Code Section 105. Generally, discriminatory coverage arises under a self-insured plan when benefits are reimbursed to an HCI under a self-insured health plan that fails to satisfy the rules for eligibility. For discriminatory coverage, the amount of the excess reimbursement for a particular HCI is determined by multiplying the total amount reimbursed to the HCI by a fraction, the numerator of which is the total benefits paid during that plan year to or for all HCIs and the denominator of which is the total benefits paid during that plan year to or for all participants.

By contrast, discriminatory benefits arise under a self-insured health plan when benefits are available to HCIs but not to all other participants in the plan. Such benefits will cause a plan to fail the rules applicable to benefits, and the amount included in an HCI's gross income as an excess reimbursement is the amount reimbursed to that HCI for the discriminatory benefit. Thus, if a benefit is available only to an HCI and not to all other participants, then the total amount reimbursed to the HCI for that benefit is includible in the gross income of the HCI. (If the benefit is available to non-HCIs but is a lesser benefit, then the amount available to the HCI will be offset by the amounts available to the non-HCIs.) In either case, an employer whose self-insured health plan is determined to violate Code Section 105(h) will not incur any taxes or liability under Section 105(h).

\$100 Per Day Penalty for Failure to Satisfy Section 2716 of the ACA: With respect to the assertion that a discriminatory self-insured health plan may be subject to penalties under the ACA of up to \$100 per day, such assertion is simply wrong. In brief, the consequences of an insured plan's failure to comply with the nondiscrimination rules are different from the consequences for a plan that is self-insured. An insured plan that fails to comply with the nondiscrimination rules is subject to a civil action to compel it to provide nondiscriminatory benefits and, for each day that the plan fails to comply, the plan or plan sponsor is subject to excise taxes or civil money penalties of \$100 per day per individual against whom the plan has discriminated. Again, by way of contrast, if a self-insured plan fails to comply with the non-discrimination rules, then amounts paid to HCIs that are considered to be "excess reimbursements" will be taxable to the affected HCIs. This difference in penalties exists

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because the penalties under the Code for discriminatory self-insured health plans were not made applicable by the ACA to insured health plans.

In Notice 2010-63, the IRS described the penalties under the ACA applicable to discriminatory insured health plans as follows:

[Section 2716 of the ACA] incorporates the substantive nondiscrimination requirements of Code section 105(h) (but not the taxes on highly compensated individuals in section 105(h)(1)) and applies them to insured group health plans. An insured group health plan failing to comply with the nondiscrimination requirements of Code section 105(h) is subject to the taxes, remedies, and penalties that generally apply for a plan failing to comply with the requirements of chapter 100 of the Code (generally, an excise tax of \$100 per day per individual discriminated against for each day the plan does not comply with the requirement), part 7 of ERISA (a civil action to enjoin a noncompliant act or practice or for appropriate equitable relief), or title XXVII of the PHS Act (civil money penalties of \$100 per day per individual discriminated against for each day the plan does not comply with the requirement). Thus, if a self-insured plan fails to comply with Code section 105(h), highly compensated individuals lose a tax benefit; if an insured group health plan fails to comply with Code section 105(h), the plan 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.

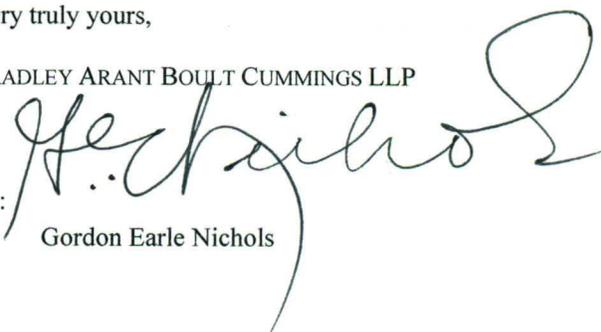
In subsequent guidance (Notice 2011-1), the IRS deferred application of these rules until after Treasury Regulations or other administrative guidance of general applicability has been issued under section 2716 of the ACA. Moreover, “[i]n order to provide insured group health plan sponsors time to implement any changes required as a result of the regulations or other guidance, the [applicable federal] Departments anticipate that the guidance will not apply until plan years beginning a specified period after issuance.”

If you have any additional questions concerning this matter, please contact the undersigned at your convenience.

Very truly yours,

BRADLEY ARANT BOULT CUMMINGS LLP

By:


Gordon Earle Nichols

GEN/sl

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