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HEALTH CARE REFORM WORKING GROUP

ALERT

The Implications of Losing "Grandfathered Plan" Status

As many employers may already know, the new health care reform law has created a special status for health care plans that allows them to be exempt from many of the law's new requirements — a status referred to as "grandfathered plan status."

What many employers may not know however, is that under new interim final regulations, if a fully insured health plan loses its grandfathered plan status, it will have to comply with the requirements of the tax code's "nondiscrimination" provisions, which prohibit a plan's more favorable treatment of highly compensated individuals. Prior to these regulations, these nondiscrimination requirements only applied to self-insured plans.

Overview of Grandfathered Plan Status

Generally, to be a grandfathered plan, the policy or group health plan must have had at least one individual enrolled on March 23, 2010. With some exceptions, any new policy, certificate or contract of insurance issued after that date is not grandfathered. Grandfathered status applies separately to each benefit package offered under a policy or plan. For example, if a plan offers three options, but replaces the insurance issuer for one of those options after March 23, 2010, that option will lose its grandfathered plan status, but the others will still be grandfathered.

The benefit of this status is that a grandfathered plan is generally exempt from the health care law's insurance reform requirements related to: preventive care; internal and external review; nondiscrimination; choice of providers; emergency care; clinical trials; cost sharing and deductibles; guaranteed issue/renewal; and rating restrictions. However, grandfathered plans are not exempt from requirements related to: annual and lifetime limits; dependent coverage to age 26; rescission; pre-existing condition exclusions; waiting periods; and employer mandates.

Changes Affecting Grandfathered Plan Status

Under the regulations, there are a number of ways that changes to health plans will result in a loss of grandfathered plan status. These include: reducing benefits in a way that results in the "elimination of all or substantially all benefits to diagnose or treat a particular condition;" increasing the fixed-amount and percentage cost-sharing requirements imposed on individuals for covered services and items; imposing or modifying an annual limit on the cost of health insurance coverage; and failing to comply with recordkeeping and disclosure requirements.

The Tax Consequences

Under these new regulations, fully insured health plans that have lost their grandfathered plan status will have to comply with the code's nondiscrimination requirements as of the earlier of: (1) the first day of the plan year beginning after September 23, 2010; or (2) the date upon which the plan is no longer grandfathered.

The tax consequences for a fully insured plan that violates the nondiscrimination requirements are different

from those affecting a self-insured plan. Instead of subjecting highly compensated individuals to additional tax, violations of the nondiscrimination requirements by a fully insured plan subject the sponsoring employer to a $100 per day, per participant excise tax, capped at the lesser of $500,000 or 10 percent of the employer's health care expenses for the previous year.

Under the tax code (§ 105(h)), "highly compensated individuals" are defined as those who are: (1) among the five highest paid officers; (2) shareholders owning more than 10 percent in value of the employer's stock; or (3) with some exceptions, the highest paid 25 percent of all employees.

Transition Rules

The regulations provide for a number of "transition rules" or exceptions to the rules that require loss of grandfathered plan status. Under one such rule, if changes to a health plan were adopted before March 23, 2010, a plan or a policy will not lose its grandfathered status, even if the change takes effect after that date. However, such changes must have been adopted under a legally binding contract, insurance filing or written plan amendment in order for a plan or policy to benefit from this rule.

Potential Problems in the Workplace

In light of the above, problems may arise if employment policies, non-binding agreements or other employment documents provide for compensation arrangements resulting in an automatic imposition of the excise tax because they discriminate in favor of highly compensated individuals and call for the issuance of a new policy after March 23, 2010.

For example, an employer with a fully-insured plan may have entered into non-binding employment agreements with high-level employees prior to March 23, 2010, that discriminate in favor of such employees and call for the issuance of new health insurance after the plan's COBRA continuation coverage has expired. Under these circumstances, and other similar circumstances that may arise, employers and high-level employees may want to consider negotiating changes to their existing agreements. In any event, all employers should review their policies, agreements and other documentation regarding health coverage for high-level employees in light of these new regulations.

The attorneys at Fox Rothschild are available to assist in reviewing health plan documents and employment agreements in light of these regulatory changes.

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