

## Continued Coverage of Former Executives Under Insured Medical Plans Can Trigger Severe Penalties Under New Healthcare Law

Under a relatively unpublicized provision of the new healthcare law (commonly referred to as the Affordable Care Act), providing free or subsidized coverage to a former executive under an insured group medical plan can subject an employer to potentially severe penalties, in some cases starting January 1, 2011. As discussed below, absent an employer's group medical plan retaining grandfathered status under the Affordable Care Act or the Internal Revenue Service (IRS) granting transition relief before year-end, affected employers will need to act promptly to change how they provide such coverage, or discontinue it altogether.

### 1. Affordable Care Act Subjects Insured Group Medical Plans to Nondiscrimination Rules

Although Section 105(h) of the Internal Revenue Code has long prohibited self-insured medical plans sponsored by employers from providing coverage or benefits that discriminate in favor of "highly compensated individuals," insured group medical plans have been free from these restrictions. By subjecting insured group health plans to nondiscrimination rules similar to those that apply to self-insured plans, the Affordable Care Act will make some formerly common practices impermissible. Key among the practices that can run afoul of the nondiscrimination rules is providing continued coverage under an insured group medical plan on a free or subsidized basis to a terminated executive as a severance benefit or as part of a retirement package.<sup>1</sup>

The general effective date for applying the nondiscrimination restrictions to insured plans is the first day of the first plan year beginning on or after September 23, 2010, although employers whose group medical plans are "grandfathered" will not be subject to the restrictions until grandfathered status is lost. As discussed in our June 2010 Advisory (*available at*: [http://www.arnoldporter.com/public\\_document.cfm?id=16044&key=13E0](http://www.arnoldporter.com/public_document.cfm?id=16044&key=13E0)) relating to grandfathered health plans, such plans, while they retain grandfathered status, are not subject to certain Affordable Care Act requirements, including the nondiscrimination restrictions being extended to insured

<sup>1</sup> Other practices that can be impacted include providing coverage to employees terminated in connection with a reduction in force or even active employee coverage if the coverage is provided to a discriminatory group.

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medical plans. In general, a plan is grandfathered if it was in place on March 23, 2010 and an event triggering loss of such status has not occurred since that date. Events that can trigger loss of grandfathered status include eliminating coverage for a condition, increasing percentage cost sharing requirements, increasing copayment requirements above specified amounts, increasing deductible or out-of-pocket maximums above specified amounts, decreasing an employer's contribution rate towards the cost of coverage by more than specified amounts, and imposing annual limits on the dollar value of all benefits below specified amounts. Under another exception, the rules may not apply to plans that cover not more than one active employee (sometimes referred to as "retiree-only" plans).

## 2. Severe Penalties for Violation of Insured Group Health Plan Nondiscrimination Rules

In IRS Notice 2010-63, the IRS takes the position that violation of the nondiscrimination rules applicable to insured group health plans results in the employer/sponsor being subject to an excise tax of US\$100 per day "per individual discriminated against" for each day the plan fails to comply. The Notice does not provide any guidance as to how "individuals discriminated against" are identified, but determining the penalty on this basis will certainly push potential penalty exposure to extreme levels in many cases. The Notice also provides that the plan would be subject to a civil action to compel it to provide nondiscriminatory benefits. The potential consequences associated with violation of the insured plan nondiscrimination rules contrast sharply with those associated with violation of the self-insured plan nondiscrimination rules. With respect to the later, affected highly compensated individuals are required to include in income all or a portion of their reimbursements under the plan, but no penalty is imposed directly on the employer.

## 3. What Employers Should Do

It is still possible that the IRS will provide some form of grandfather relief for insured medical plan coverage already in effect or that is required to be provided pursuant to a binding contractual commitment. As a result, it appears generally advisable to temporarily hold off implementing changes. However, in light of the limited amount of time remaining to address arrangements that, absent grandfathering, may violate the new nondiscrimination requirements, employers who sponsor insured group medical

plans should consider taking the following steps to assess how the new rules may impact their plans and arrangements:

- **Identify Any Coverage in Effect or Contractual Rights to Coverage That May Violate New Nondiscrimination Requirements.** Employment agreements, severance plans and agreements, and retiree medical plans and agreements should all be reviewed to identify coverage rights.
- **Determine Whether Insured Group Health Plan is Grandfathered.** Assuming the group health plan was in place on March 23, 2010, all changes made to the plan since March 23, 2010 should be identified and evaluated to determine whether the plan is grandfathered.
- **Develop a Compliance Strategy.** Achieving compliance with the nondiscrimination rules can generally be accomplished in a number of ways, ranging from terminating coverage rights to extending coverage on a nondiscriminatory basis to non-executives. How best to achieve compliance will depend on a range of factors including whether the coverage is already in effect, the remaining term of applicable contractual commitments, and Section 409A compliance considerations.

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*We hope that you find this brief summary helpful. If you would like more information or assistance in addressing the issues raised in this advisory, please feel free to contact your Arnold & Porter attorney or:*

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