March 11, 2011

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Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20224

Submitted Electronically: Comments@irscounsel.treas.gov

Re: Notice 2011-1 Failure to Meet Certain Group Health Plan Requirements

These comments are submitted to the Internal Revenue Service, to be shared with the Departments of Labor and Health and Human Services (together with the Department of the Treasury, "the Agencies"), pursuant to Notice 2011-1, published in the Internal Revenue Bulletin, 2011-2 IRB 259 (Dec. 12, 2010), on behalf of the Small Business Coalition for Affordable Healthcare. As requested in Notice 2011-1, the subject of these comments are issues that should be addressed in guidance from the Agencies under Section 2716 of the Public Health Service Act ("PHSA"), as added by the Patient Protection and Affordable Care Act, Pub. L. 111-148, as amended by the Health Care and Education Reconciliation Act, Pub. L. 111-152 (together, "the Affordable Care Act" or "the ACA").

Representing the country's largest, oldest and most respected small business associations, the Small Business Coalition for Affordable Healthcare ("the Coalition") has spent more than a decade working to increase access and affordability of private health insurance. The coalition's membership includes small business organizations in the agricultural, construction, food service, floral, wholesaler, retail, rental, entertainment and house ware communities. As part of the nation's leading small business coalition, our members actively participated in the healthcare debate and advocated for solutions that would increase choice, enhance competition for private insurance and increase the overall affordability of health insurance for our country's job creators: America's small businesses.

Preliminary Statement

PHSA § 2716(a) provides that "[a] group health plan (other than a self-insured plan) shall satisfy the requirements of section 105(h)(2) of the Internal Revenue Code of 1986 (relating to prohibition on discrimination in favor of highly compensated individuals)." Section 105(h)(2) of the Internal Revenue Code of 1986, as amended ("the Code") provides that "[a] self insured medical reimbursement plan satisfies the requirements of

this paragraph only if (A) the plan does not discriminate in favor of highly compensated individuals as to eligibility to participate; and (B) the benefits provided under the plan do not discriminate in favor of participants who are highly compensated individuals." Because the requirements of Section 105(h)(2) apply only to self-insured medical reimbursement plans, an insured group health plan cannot satisfy those requirements in the literal sense.

The Coalition construes PHSA § 2716(a) as a delegation of authority to formulate nondiscrimination requirements for insured group health plans based on Code § 105(h)(2)(A) and (B). Accordingly, in the Coalition's view, the Agencies have the leeway necessary to provide guidance under PHSA § 2716. In further support of this view, the Coalition notes under PHSA § 2716(b)(1), all that is required is that "[r]ules similar to those contained in paragraphs (3), (4), and (8) of section 105(h) of such Code . . . apply." Careful guidance is necessary since these rules will apply to insured plans for the first time. Because small businesses are more likely to purchase insured plans, failure to provide appropriate guidance could have a detrimental impact on small businesses and their employees.[1]

While we have general concerns about the application of nondiscrimination rules to insured plans, failure to provide adequate guidance and protections for small business could lead to extremely negative results. As we will discuss in further detail, the application of penalties is likely to be especially onerous on businesses offering insured plans. The financial penalties for the employer involved in the same instance of discrimination in favor of highly compensated individuals could be hundreds of thousands of dollars when a plan is fully insured versus merely hundreds of dollars when a plan is a self-insured arrangement.

In addition, because of the different way these anti-discrimination rules apply to insured plans would mean that these penalties fall especially hard on the small business population. First, many small businesses are likely to face challenges complying with the highly compensated employee test simply because of the size of their company. Second, small businesses are also less likely to have the necessary resources to comply with these complex rules. Because of the unique circumstances facing small businesses, we urge the Agencies to consider several suggestions to mitigate the likely negative effect of simply applying the rule as it stands.

Enforcement Mechanisms for Anti-Discrimination Rules

How the Agencies will exercise their authority under PHSA § 2716 is a matter of great importance to the employer community, including the Coalition and its members. Guidance issued under the nondiscrimination requirement of PHSA § 2716 will have serious consequences for many employers that sponsor fully insured group health plans.

[1] According to the Agency for Healthcare Research and Quality's 2009 Medical Expenditure Panel Survey-Insurance Component, 14 percent of private-sector establishments with fewer than 100 employees that offer health insurance, offer at least one self-insured plan.

This is because the Affordable Care Act established two specific mechanisms to enforce PHSA § 2716; sponsors of insured plans are punishable by either litigation or large financial penalties for a violation of the rules.

First, the Affordable Care Act added Section 715 to ERISA, which among other things, requires the nondiscrimination rules to apply to group health plans (other than self-insured group health plans) covered by ERISA §§ 701-734. Compliance with the legal rules developed by the Agencies in connection with PHSA § 2716 are therefore enforceable directly against employers under ERISA § 502(a)(3) through lawsuits against plan sponsors. This exposes small businesses to the unpredictable costs of lawsuits, many of which may even inaccurately claim that the plan discriminates unlawfully in favor of highly compensated individuals.

Second, the measures under the Agencies' consideration with regard to Section 2716 will affect an employer's exposure to an excise tax under Code Section 4980D which generally imposes an excise tax of $100 per day per person affected by a group health plan's failure to meet the requires of Code §§ 9801 - 9834.[2] Thus, depending on the substantive rules developed by the Agencies, an employer could be at risk of liability for a punitive and non-deductible penalty. Because the excise tax under Section 4980D is expressed as a dollar amount per day per person affected, it can be disproportionately large for a small employer. For example, if a business with 60 employees fails to satisfy what is determined to be the content of Section 2716 with respect to half its employees for a year, its excise tax could equal $1,095,000.[3]

In contrast, the sponsor of a self-insured plan who fails to comply with the same nondiscrimination rules would not be subject to the possible lawsuits or the excise tax penalty. Instead, the self-insured plan sponsor does not face a tax penalty under section 105(h), instead the highly compensated employee is required to pay a tax penalty on the benefits received under the discriminatory plan. Clearly, this modest indirect financial penalty assigned to the self-insured plan sponsor is significantly less than the per employee-per day penalty imposed on the sponsors of insured plans under section 4980D.

Because small businesses are more likely to offer insured plans, the application of these anti-discrimination rules to these plans are likely to have significant negative consequences for many small businesses. First, many businesses would likely find themselves in violation of the rules and subject to severe financial penalties, because of the way these companies have been permitted to operate and structure plans in the past.

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[2] This is true because Code § 9815, as added by the Affordable Care Act, provides among other things that the provisions of PHSA § 2716 shall apply to group health plans (other than self-insured group health plans).

[3] Code § 4980D establishes an alternative limit on the excise tax for failures that are "due to reasonable cause and not to willful neglect." Code § 4980D(c)(3). The limit for single employer plans is the lesser of $500,000 or 10 percent of the amount paid or incurred by the employer or its predecessor for group health plans during the preceding year. *Id.* Because the limit applies only if there is reasonable cause, it is unclear if and when exposure to the Section 4980D excise tax is reduced.

Given the complexity of these rules, small businesses will need adequate time and guidance to comply.

Second, this disparity may incent some businesses to move to self-funded plans because of the more advantageous penalty provisions. As we noted earlier, the sponsors of insured plans will risk steep penalties of both lawsuits and a high excise tax, while the sponsors of self-insured plans will only incur a much smaller, indirect penalty. The cost of failing to comply with the rules is much higher for the insured plan sponsored. Unfortunately, for many small businesses sponsoring a self-funded plan is not an option. This would mean that businesses unable to offer such a plan are left with the choice of sponsoring an insured plan and running the risk of lawsuits and higher penalties or offering no plan at all. None of these are the intended results of the provisions included in ACA, but are real possibilities.

Specific Proposals to Mitigate the Impact on Small Businesses

Given the potential penalties that a small business could face for failing the anti-discrimination tests, the Coalition believes there are a few relatively simple steps the Agencies could take to postpone and reduce the impact on small employers and their employees. These changes will preserve the coverage currently offered by small businesses and valued by millions of employees.

Extend the Implementation Deadline

Many of the changes included in the ACA do not take effect until 2014, in particular, insurance exchanges, the individual requirement to purchase health insurance, and the minimum essential coverage requirements. These changes will have a substantial impact on the insured market, since plans purchased through the exchanges, whether by an individual or a small business, are likely to be insured plans. The impact of these changes on the insured market could also have an impact on the application of nondiscrimination rules.

For these reasons, the Coalition asks the Agencies to give strong consideration to postponing the implementation date of any such measures until 2015, the first year after exchange-compliant policies are available. Revisiting the application of the nondiscrimination rules after changes are made to the overall market in 2014 would be counterproductive and could unintentionally place many smaller firms outside of compliance.

Sufficient Time for Implementation

Given the complexities in the current rule and the difficulty in applying the rule to new plans, the Coalition urges the Agencies to follow a traditional informal rulemaking process to implement the nondiscrimination rules in the ACA. By issuing a proposed rule, the Agencies will be able to solicit input from those affected and increase the possibility that employers and plans will be able to comply with and implement the final

rule. In addition, proposed rules would provide small businesses with more time and clearer guidance, which will assist them in preparing for and meeting the compliance standards. Applying complicated rules with potentially steep penalties to sponsors of insured plans without adequate input or time will have a negative impact on the plan sponsors.

Small Business Safe Harbor

The Coalition believes that several carefully-tailored safe harbor provisions could be used to avoid the disproportionate impact that the application of nondiscrimination rules will have on small businesses offering insured plans. Because of the small number of employees, small businesses will struggle with the current highly compensated employee tests included in section 105(h)(5). The current tests that look to the five highest paid officers or the highest paid 25 percent of employees will mean that one quarter of all employees will be always be categorized as highly compensated employees, even though they may not be highly compensated.

The HCI Simplification Safe Harbor described below is one possible alternative test that could meet the unique characteristics of small business and provide a more workable test.

<u>HCI Simplification Safe Harbor</u>

PHSA § 2716 adopts the definition of "highly compensated individual" in Code § 105(h)(5). Thus, the Coalition assumes that the Agencies' guidance on Section 2716 testing will follow the statutory definition of "highly compensated individual" precisely.

However, this does not necessarily mean that the Agencies are powerless to develop rules that small businesses can use to simplify the identification of the relevant groups of HCIs and non-HCIs for purposes of what we will call "Section 2716 testing." The task delegated to the Agencies in PHSA § 2716 includes deriving rules "similar" to those in Code Sections 105(h)(3), (4), and (8). Code Section 105(h)(3)(A) & (ii) provides that a plan satisfies the non-discriminatory classification test if the plan benefits "such employees as qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of highly compensated individuals."

The Coalition submits that Code Section 105(h)(3)(A) & (ii) provides the Agencies with the discretion to create a safe harbor under PHSA § 2716 for insured plans that do not discriminate in favor of owner-employees and officers. With respect to small businesses, the owner-employees and the top non-owner officers are what might be called the "target audience" for disincentives under Section 2716, because they are the decision-makers when it comes to plan design. Under the proposed safe harbor, the Agencies would establish that a classification of employees into "decision-makers" and "non-decision-makers" is reasonable in a business employing a certain number of total employees.

While not the only viable option for a small business safe harbor, we believe the HCI Simplification Safe Harbor is one possible mechanism for ensuring small business

compliance with the application of nondiscrimination rules. We would welcome the opportunity to work with the Agencies to further develop and refine such a safe harbor. Additionally, we would like to work with the Agencies to develop alternative safe harbors that meet the needs of small business and their employees.

The Coalition appreciates the opportunity to comment and provide the unique prospective of small businesses. We look forward to working with you to ensure that the new rules meet the needs of small businesses.

Thank you for your time and consideration.

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American Rental Association
American Society of Association Executives
American Supply Association
Associated Builders and Contractors, Inc.
Commercial Photographers International
Evidence Photographers International Council
Food Marketing Institute
International Franchise Association
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National Retail Federation
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