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Jim Wrye
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Re: **Interpretive Opinion No. 02-15, Using Nondiscriminatory Employee Classifications and the Look-Back Measurement Method in Compliance with the Affordable Care Act**

Dear Mr. Wrye,

The Division of Insurance of the Tennessee Department of Commerce and Insurance ("Division") is in receipt of the request for an interpretive opinion submitted by the Tennessee Education Association. This request seeks guidance regarding nondiscrimination classifications built into Tennessee School Board Systems' self-insured medical reimbursement plans and potential compliance issues under the Affordable Care Act ("ACA"). The request also seeks clarification regarding use of the look-back measurement method for determining full or part time status of new employees.

The facts as understood by the Division are as follows:

Insurance brokers within the State of Tennessee made various representations to Tennessee School Board Systems regarding new or different ACA compliance requirements for their self-insured medical reimbursement programs. These brokers indicated that should a school board's self-insured health plan discriminate in favor of highly paid individuals, the school board would be subject to additional taxes and liabilities pursuant to section 105(h) of the tax code or a one hundred dollar ($100) per day fine under section 2716 of the ACA.

Additionally, the Division understands these insurance brokers represented to Tennessee School Board Systems that the look-back measurement method is only a permissible means of determining employer shared responsibility under the ACA for employees working in either a seasonal or varying schedule capacity. These brokers asserted that the look-back measurement method is inappropriate for any fixed hour employee, regardless of the duration of those fixed hours.

It is the position of the Division that the representations made by these insurance brokers are misleading, inaccurate, and unsupported by either the tax code or the ACA.

Nondiscriminatory Classifications and Highly Compensated Individuals[1]

Section 2716 of title XXVII of the Public Health Service Act (as amended by the ACA) provides that group health plans (other than self-insured plans) shall not discriminate in favor of highly compensated individuals and mandates compliance with 26 U.S.C. §§ 105(h)(3), (4), and (8). *See* 42 U.S.C. § 300gg-16 (2010). This section specifically excludes self-insured plans from its rules regulating the prohibition on discrimination in favor of *highly compensated individuals*. *Id.* For the purposes of this opinion, the term highly compensated individual includes the top five (5) highest paid officers in an organization, a shareholder owning more than ten (10) percent in value of the employer's stock, or an individual among the highest paid twenty-five (25) percent of employees. 26 U.S.C. § 105(h)(5) (2010); *see* § 300gg-16(b)(2). Contrary to the guidance provided by the brokers at issue here, any ACA enacted change to section 2716 of title XXVII of the Public Health Service Act is inapplicable to the self-insured plans offered by Tennessee School Board Systems.

26 U.S.C. § 105(h) applies with respect to self-insured group health plans and prohibits medical reimbursement plans from discriminating in favor of highly compensated individuals in regards to participation eligibility and benefits provided. § 105(h)(2). Despite this prohibition, plans may provide different benefits to different employee classifications, provided such classifications are not discriminatory. § 105(h)(3)(A)(ii).

Additionally, the nondiscriminatory classification test requires an employer implemented classification be reasonable[2] and established under objective business criteria. 26 C.F.R. §§1.105-11(c)(2)(ii) (1960), 1.410(b)-4(b) (1960). Furthermore, for such a classification to be considered nondiscriminatory, the group of employees must satisfy either nondiscriminatory safe harbor requirements[3] or nondiscriminatory facts and circumstances.[4] §§1.105-11(c), 1.410(b)-4(c).

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[1] As early as 2011, it was clear self-insured plans were exempted from the highly compensated individual requirements and penalties prescribed by the ACA; "[t]he reform law also exempts self-insured plans from several key requirements. The reasoning behind some of these exemptions is obvious – self-insured plans, for example, are not subject to the medical loss ratio requirement, which only applies to insurers, or to the prohibition against discrimination in favor of highly-compensated employees, which already applied to self-insured plans." Timothy Stoltzfus Jost, *Loopholes in the Affordable Care Act: Regulatory Gaps and Border Crossing Techniques and How to Address Them*, 5 St. Louis U.J. Health L. & Pol'y 27, 29 (2011).

[2] Generally accepted reasonable classifications include classification by: specific job category; compensation structure; and geographic location. 26 C.F.R. § 1.410(b)-4(b) (1960).

[3] A plan classification is nondiscriminatory if the plan's ratio percentage for the plan year is greater than or equal to the safe harbor ratio described in 26 C.F.R. § 1.410(b)-4(c)(4)(i). 26 C.F.R. § 1.410(b)-4(c)(2).

[4] If a plan's ratio percentage is greater than or equal to the unsafe harbor percentage found in 26 C.F.R. § 1.410(b)-4(c)(4)(iii), and meets certain factual criteria, plan classifications will be considered nondiscriminatory. 26 C.F.R. § 1.410(b)-4(c)(3)(i). Pertinent nondiscriminatory classification factual considerations include the underlying business purpose for the classification, the percentage of the employer's workforce benefiting under the plan, how closely related are the number of employees in each salary range of the plan beneficiaries and in the employer's

When a self-insured plan provides benefits or eligibility to a highly compensated individual, but not other employees, the plan is discriminatory. In the event a self-insured plan discriminates as to eligibility or benefits in favor of highly compensated individuals, then those individuals will be taxed for the receipt of such plan as an excess reimbursement which would have otherwise been excluded from the highly compensated individual's gross income. *See* § 105(h)(1), (7). Regardless of the manner by which the self-insured plan discriminates in favor of highly compensated individuals, the ACA does not generally impose a penalty on the employer; rather, it is the individual who is subject to additional taxes or liabilities under section 105(h)[5].

Section 2716 of title XXVII of the Public Health Service Act (as amended by the ACA) does not impose a one hundred dollar ($100) per day penalty on discriminatory self-insured medical reimbursement plans. Rather, 42 U.S.C. § 300gg-22 imposes a one hundred dollar ($100) per day violation penalty on insurance plans governed by 42 U.S.C. 300gg *et seq.* § 300gg-22 (2010). The penalties prescribed under § 300gg-22 do not apply to self-insured plans because the prohibitions on discrimination in favor of highly compensated individuals set forth in § 300gg-16 exempt self-insured plans from such regulation. While this provision is applicable to some types of discriminatory insurance plans, a one hundred dollar ($100) per day penalty for violation of § 300gg-16 does not apply to self-insured plans. Rather, the only available penalty for discriminatory self-insured medical reimbursement plans is that any "excess reimbursements" paid to highly compensated individuals are taxable to those individuals.

Look-Back Measurement Method

The ACA's shared responsibility for employers provisions provide that applicable large employers[6] must make an offer of reasonably affordable minimum essential coverage to substantially all of its full time employees[7] or be subject to penalties, provided the employees obtain subsidized coverage on a state or federal health insurance exchange. 26 U.S.C. § 4980H (2010). However, if an employee is expected to be only a part time employee, the employer is not required to make any offer of coverage to those employees.[8] *See* 26 C.F.R. § 54.4980H-2(b)(1) (2014). When an employer is unable to determine whether a new variable hour or seasonal[9] employee is a full time employee, the employer may use the look-back measurement method to make this determination.

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workforce, the difference between the ratio percentage and the employer's safe harbor percentage, and the extent to which the plan's average benefit percentage exceeds seventy (70) percent. 26 C.F.R. §§ 1.410(b)-4(c)(3)(ii)(A)-(E).

[5] To extent that the individual has additional wages, such wages will also be subject to the employer share of FICA taxes under §3111.

[6] An applicable large employer is one "who employed an average of at least 50 full-time employees on business days during the preceding calendar year." 26 U.S.C. § 4980H(d)(2)(A) (2010).

[7] A full time employee is one "who is employed on average at least 30 hours of service per week." 26 U.S.C. § 4980H(d)(4)(A) (2010).

[8] However, it should be noted that if an employer decides to offer its part time employees health coverage, these part time employees should be considered in the classification discrimination testing under § 105(h).

[9] Seasonal employees are those who work non-continuously, exclusively during certain seasons or periods of the year. 26 U.S.C. § 4980H(d)(2)(B)(ii); 29 C.F.R. 500.20(s)(1) (1997).

If an employee, on their start date, is reasonably expected to work fewer than thirty (30) hours per week, that employee is a part time employee. *See* § 4980H(c)(4). Consequentially, if an employee is reasonably expected to work fewer than thirty (30) hours per week, an employer is under no obligation to offer that employee health coverage. Furthermore, if an employee, on the date of hire, is expected to be a part time employee, an employer may choose not to offer coverage to that employee without utilizing the look-back measurement method safe harbor.

Variable hour employees are those for whom, on their start date, based on facts and circumstances, it cannot be determined that the employee will be reasonably expected to be employed on average at least thirty (30) hours of service per week. 26 C.F.R. § 54.4980H-1(a)(49) (2014). The look-back measurement method determines an ongoing seasonal or variable employee's full time status by looking back at a standard measurement period[10] to determine if that employee maintained a minimum average of thirty (30) hours of service per week during that period. 26 C.F.R. § 54.4980H-3(d)(1)(i) (2014). If an employee is determined to be full time during the standard measurement period, that employee must be treated as such for the following stability and administrative periods, regardless of change in employment status. § 54.4980H-3(d)(1)(vii).

The insurance brokers, in advising the Tennessee School Board Systems regarding variable employees under the look-back measurement method, misrepresented the nature of variable hour employees. For the purposes of this safe harbor test under section 4980H, a *variable hour employee* is not one who works differing hours from day to day. Rather, a *variable hour employee* is one who cannot be reasonably determined to work an average of at least thirty (30) hours per week on the employee's start date. *See* § 54.4980H-1(a)(49). A variable hour employee may work during the same time frame each day, but if the cumulative hours do not exceed thirty (30) hours per week, that employee is a variable hour employee for the purposes of the look-back measurement method.

Please note that the Division has not made an independent investigation of the facts to determine the accuracy or completeness of the information supplied, but has instead relied solely upon the information you have provided. If such information is incorrect or changes substantially, it would be necessary for the Division to reconsider the matter, and the position stated herein would be void. This letter expresses the Division's position on enforcement action only and does not purport to express legal conclusions on the issues presented. This position is furnished solely for the benefit and use of the entities described herein. Please be advised that further publication or use of this position may only be made with the Division's prior written consent.

This response by the Division is to a specific fact situation relating to the interpretation of the Affordable Care Act and related tax code provisions and should not be construed as a legal position or opinion of the Commissioner of the Tennessee Department of Commerce and Insurance or of any other official in the Department. Please note that the conclusions contained

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[10] A standard measurement period may be set at the discretion of the employer, but must be applied uniformly and consistently to all employees within the same category. 26 C.F.R. § 54.4980H-3(d)(1)(i)-(ii) (2014). Standard measurement periods may differ per group of employees, provided the groupings contemplate (1) collectively bargained employees vs. non-collectively bargained employees, (2) each group of collectively bargained employees, (3) salaried employees vs. hourly employees, or (4) employees working in different states. § 54.4980H-3(d)(1)(v).

herein are based upon the representations that have been made to the Division, and any different facts or conditions might require a different response. As each inquiry is reviewed on the specific facts presented, this response is based only on such facts and may not be used as precedent by any person or entity. Any variation in the facts presented to the Division by Mr. Jim Wrye could result in a different conclusion than asserted herein.

If you have further questions or concerns regarding this letter, please feel free to contact me.

By: 

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